83-443

No. . . . .

In The

Supreme Court of the United States

October Term 1983

U.S.S. Polypropylene Division, A Division of United States Steel Corporation,
Petitioner,

v.

Studiengesellschaft Kohle m.b.H.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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September 1, 1983

QUESTIONS PRESENTED

1. In view of the paramount federal interest which requires candor and honesty in the procurement, licensing and use of patent rights, should the Second Circuit have condoned a patent owner's concealment of more favorable license terms in a later license in breach of its contractual obligation under a "most favored licensee" clause, thus preventing the "most favored licensee" holder from having the opportunity to accept the later license terms?

2. Should this Court exercise its power of supervision where the Court of Appeals departed from the usual course of judicial proceedings by (a) refusing to hold as a matter of law that a patent owner must disclose more favorable royalty provisions in later licenses to give the first licensee the opportunity to make a binding choice and thereby avoid any basis for litigation on that point, and (b) having thus created the need for the court to equalize the royalty provisions in the several licenses, refusing to resolve that need by stating that such resolution "would place the court in the position of an arbitrator."

3. As between conflicting positions taken by the Second Circuit below and the Sixth Circuit in *Shatterproof Glass Corp.* v. *Libby-Owens-Ford Co.*, 482 F.2d 317 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974), was the Second Circuit correct in:

(a) holding as a matter of law that a "most favored licensee" clause does not require consideration by the court of arguably more favorable royalty provisions in a later license which deducted payments for past infringement from royalty payments due in the future?

(b) placing the burden of proof on Petitioner-Licensee to show more favorable terms in later licenses even though the Petitioner-Licensee had established a breach of contract by the patent owner's purposeful concealment of accurate and complete information as to such later licenses?

As of January, 1982, Petitioner Novamont Corporation (Novamont) was no longer a corporation; it became and is now U.S.S. Polypropylene Division, a Division of United States Steel Corporation, a Delaware corporation. The foregoing information is supplied under Supreme Court Rule 28.1.

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Petitioner,

v.

Studiengesellschaft Kohle m.b.H.,

Respondent.

PETITION FOR WRIT OF CERTIORARI

Petitioner respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit (Court of Appeals) entered in the above entitled case on March 28, 1983.

Opinions Below

The Opinion of the Court of Appeals rendered March 28, 1983 is reported at 704 F.2d 48 (2d Cir. 1983) [Appendix A hereto, (cited herein as "Pet. App. A1")]. The Opinion of the United States District Court for the Southern District of New York entered June 30, 1981 is reported at 518 F.Supp. 557 (S.D.N.Y. 1981) [Appendix B hereto (cited herein as "Pet. App. B1")].

Jurisdiction

After the Judgment of the Court of Appeals was entered, a petition for rehearing with a suggestion for rehearing en banc was timely filed on April 11, 1983. The petition for rehearing was denied by an Order dated May 12, 1983 [Appendix C hereto (Pet. App. C1)]. An application for extension of time in which to file this petition for writ of certiorari was filed within ninety days thereafter on August 8, 1983, and an Order Extending Time to File Petition for Writ of Certiorari to September 1, 1983 was entered August 9, 1983 by Justice Thurgood Marshall [Appendix D hereto (Pet. App. D1)]. The jurisdiction of this Supreme Court is invoked pursuant to 28 U.S.C. § 1254(1).

Constitutional and Statutory Provisions Involved

This case involves Article I, § 8, Cl. 8 of the United States Constitution, [Appendix E hereto (Pet. App. E1)] and Title 35, U.S.C. § 1, et. seq.

Statement of the Case

The federal jurisdiction of the United States District Court was invoked by Respondent Studiengesellschaft Kohle m.b.H. (SGK), a West German corporation against Petitioner Novamont Corporation (Novamont), now a Division of United States Steel Corporation (Novamont) under 28 U.S.C. § 1332(2). United States Patent No. 3,113,115 ("'115"), which has been assigned to SGK, relates to a certain polymerization catalyst used for making polymerized chemicals such as polypropylene commonly called "plastics." The '115 patent, which expired in 1980, was licensed by a number of United States companies. Petitioner was one of the licensees under that patent. At the time Petitioner entered into the license, Dr. Karl Ziegler of West Germany was the owner of the '115 patent although at the time the litigation was instituted the title of the '115 patent had been assigned to Respondent SGK.

The patent license agreement entered into with respect to the '115 patent was effective January 1, 1967 and it included as Article IX a most favored licensee clause ("MFL") which reads as follows:

> "A. 1) Should Licensor, during the life of this Agreement, grant to any company producing Agreement Polymers in the United States a license under United States patent 3,113,115 which license contains *royalty provisions that, when considered in their entirety, are more favorable* than those specified in Article III hereof, then and in that event Licensor shall promptly furnish Licensee with the full text of the royalty provisions of such license." (Emphasis added.)

On July 1, 1970, Ziegler entered into a license agreement with Diamond Shamrock Corporation (Diamond) granting Diamond terms which were more favorable than those granted to Novamont. The District Court found that Ziegler "concealed from Novamont the additive credit features of his 1970 contingent agreement and final 1974 settlement agreement with Diamond Shamrock", 518 F.Supp. 570.* The concealed terms of the Ziegler/Diamond agreement stated that Diamond was to pay $750,000 to Ziegler for past infringement, but such amount was to be credited towards royalty payments due under the license for the future use of the patent. Both the District Court and the Court of Appeals excused such concealment by Ziegler *as a matter of law* because the payment was for past infringement in settlement of infringement claims — despite the fact that future royalty rates were materially affected by the deduction. The District Court did not cite *Shatterproof Glass Corp.* v. *Libby-Owens-Ford Co.*, 482 F.2d 317 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974). While the Court of Appeals cited

* Petitioner entered into a new agreement with SGK on July 1, 1974 which reactivated the 1967 Agreement without knowledge of the secret Ziegler/Diamond agreement to deduct the $750,000 (denominated as past infringement) from future royalties, and with incomplete information as to the Ziegler/Hercules license.

Shatterproof in Footnote 5 (Pet. App. A-6), it refused to follow the holding of the Sixth Circuit which required consideration of *all* royalty provisions in a later license in evaluating whether such provisions were more favorable than those granted the first licensee.

Promptly upon learning of the concealed Ziegler/Diamond agreement, Novamont gave written notice to substitute the terms of the Diamond license on August 26, 1977.

This case does not involve an interpretation of provisions of the patent license agreements since the Second Circuit found the terms clear. As a matter of law, however, it refused to give them effect in conformance with the *Shatterproof* holding. What this case involves is the question of whether, as a matter of sound public policy, a patent owner should be required to disclose *all* royalty provisions to a "most favored licensee" holder so that such holder has an opportunity to accept such later licenses or the patent owner should be held to have breached its duty of candor and honesty relating to the use of patent rights. We are here concerned with the specific policy of the patent law dealing with federal patent rights and therefore, the legal relations which they affect must be deemed governed by federal law having its source in the patent statutes, 35 U.S. 1 et. seq., and the U.S. Constitution. *Unarco Indus. Inc.* v. *Kelley Co.*, 465 F.2d 1303, 1306 (7th Cir. 1972) following *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U.S. 173, 176, 63 S.Ct. 172, 87 L.Ed. 165 (1942). *Cf. Gamewell Mfg. Inc.* v. *HVAC Supply, Inc.*, No. 82-1533, Slip. op. (4th Cir.Aug. 9, 1983). This case also involves a conflict between the law set forth by the Court of Appeals below and the law as set forth by the Sixth Circuit in the *Shatterproof Glass* case, cited *supra*, and also in *DeForest Radio Telephone & Telegraph Co.* v. *United States*, 273 US. 236, 47 S.Ct. 366, 71 L.Ed. 625 (1927), which was relied upon by the *Shatterproof* court.*

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* Although the new Court of Appeals for the Federal Circuit (CAFC) has jurisdiction over patent infringement actions arising

Under the letter agreement between Ziegler and Diamond found by the District Court to have been kept secret or concealed (518 F.Supp 570), the $750,000 payment for "past infringement" was treated as if it were a down payment on future royalties due under the license so that, in reality, the $750,000 was a deduction from royalties Diamond had to pay for the *future* operation under the license. The refusal of the Court of Appeals to consider the effect of such royalty deduction as required by *Shatterproof* resulted in Petitioner having a less favorable license in the amount of the $750,000. Moreover, the Court of Appeals' refusal and its condonement of Ziegler's concealment of facts encourages licensees to conceal more favorable license terms from licensees in the enforcement of rights governed by the Constitution and the federal patent statute, 35 U.S.C. 1, et. seq.

The Diamond concealment was not SGK's only concealment. A second license was entered into between Ziegler and Hercules Corporation on April 26, 1972. As recognized by both the District Court (Pet. App. B-21), and the Court of Appeals (Pet. App. A-15), although Ziegler's attorney disclosed the total royalty provided in the agreement, the "full text" of the Ziegler/Hercules agreement was not furnished as required by the Novamont MFL clause. Specifically concealed was a 20% contingency discount (Pet. App. B-21) and a June 21 telex which acknowledged a "further admitted discount to Hercules". When SGK's attorney asked SGK if he should furnish Novamont with a copy of the Hercules agreement, SGK blatantly instructed him, "Do not forward Hercules agreement because we do not want discount in a further paid-up license".

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in whole or in part under 28 U.S.C. §1338, as provided for in 28 U.S.C. §1295, the conflict between the circuits here presented will not likely be presented to the CAFC because the rights involved here do not come within that court's jurisdiction under the above statutes, nor can it be demonimated a pendent claim of unfair competition under §1338(b). Therefore, if this Court does not resolve the conflict between circuits, it will continue to foment unnecessary litigation.

Thus, Ziegler again breached the MFL clause agreement with Novamont by concealing the true picture of the royalty arrangement between Ziegler and Hercules. Further, the Hercules license was clearly more favorable than Petitioner's license because Hercules was given the privilege of a paid-up license based on its choice of plant capacity. Petitioner was not given an opportunity to accept such a privilege. Since Petitioner's plant had a much lower capacity than Hercules, a lump sum royalty to Petitioner calculated on the same basis as that of Hercules would have been a great deal less.

Because the royalty in the Ziegler/Hercules 1972 agreement was a lump sum royalty rather than the running royalty of the Ziegler/Novamont agreement, the Court of Appeals declined to consider whether the different format of the royalties paid by Hercules gave Hercules more favorable terms. The court was obligated to make this judgment based on its judicial responsibility and elemental rules of fairness. Moreover, its refusal to do so was contrary to the holding in a like situation in *Shatterproof Glass Corp. v. Libby-Owens-Ford Co.*, 482 F.2d 317, 324 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974).

Petitioner entered into its agreement with SGK on July 1, 1974 without knowledge of the secret Ziegler/Diamond agreement to deduct the $750,000 from future royalties, and with incomplete information as to the Ziegler/Hercules license.

Not only did the court below ignore the improper concealment by Ziegler (SGK), but the Court of Appeals placed on Petitioner the burden of proving that the terms of the Ziegler/Diamond license and the Ziegler/Hercules license were more favorable than the terms of the Ziegler/Novamont license, even though Novamont had shown a breach of the contract by Ziegler's purposeful concealment of the full text and total royalty information with respect to the two licenses and even though SGK was in the better position to evaluate the comparability of the royalty provisions. At the very least, the burden of proof should have shifted to Ziegler upon the showing of the breach by Ziegler as

held in *Shatterproof Glass Corp.* v. *Libby-Owens-Ford Co.*, 482 F.2d 317, 324 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974).

REASONS FOR GRANTING THE WRIT

1. This Court Has Not Settled the Question of Whether a Patent Owner Can Misuse Its Patent Rights by Concealing From a Licensee Unequal Provisions in Subsequent Licenses Granted to Competitors of a Licensee Who Has Bargained For "Most Favored Licensee" Treatment

A. *The Importance of the Question*

Virtually every patent license has a "most favored nations" or "most favored licensee" clause. Such clauses are also common in other contracts, including government consent decrees which often include MFL provisions to restore competition. See, for example, the facts in *Shatterproof*. The purpose of these clauses is to provide equal royalty terms between licensees so that each party who takes a license from a patent owner will be able to compete in the marketplace with its competitors on an equal basis insofar as the licensed cost for the patented product or process is concerned.

Patent licensing is the backbone of the patent system as well as a major contributor to international trade and the transfer of technology by U.S. companies. Patents are most often used commercially through the granting of exclusive and non-exclusive licenses. This is particularly true with respect to a patent such as the one involved in this case, which involved a process for polypropylene manufacture by a number of major companies in the United States and other parts of the world.* So far as Petitioner has been able to determine, no published official data is

* The litigation involving the Ziegler patent 3,113,115 has been extensive; it includes the following cases: *Eastman Kodak Co.* v. *SGK*, 392 F.Supp. 1152 (D. Del. 1975); *SGK* v. *Eastman Kodak Co.*, 450 F.Supp. 1211 (E.D. Tex. 1977), *aff'd in part, rev'd in part*, 616 F.2d 1315 (5th Cir. 1980), *cert. denied*, 449 U.S. 1014 (1980); *SGK* v. *Dart Industries, Inc.*, 549 F.Supp. 716 (D. Del.

available on the number of patent licenses which are in effect annually in the United States, or the total dollars involved in such licenses, but based upon published information which has become available to the Petitioner through the Licensing Executive Society (LES) and publications such as "Licensing in Foreign and Domestic Operations" by Eckstrom, Vol. 1, pp. 163-165 (1982), it is estimated that royalties involved in domestic and international business of United States parties on an annual basis are in the neighborhood of several billion dollars.

When patent licensees who have most favored licensee clauses are deprived of the necessary information to evaluate whether the terms in later licenses are more favorable, expensive controversy and litigation results, causing a further increase in the workload of the courts. Exercise of this Court's power of supervision to prevent concealment of such patent license information would go far in reducing controversy and litigation and in promoting fair dealing among patent owners and licensees. Fair dealing requires full disclosure.

B. *Although the Misuse of Patents Has Been Consistently Condemned by This Court in a Variety of Circumstances, the Misuse Resulting From a Patent Owner's Concealment of Information Between Licensees Where Disclosure is Required by a Most Favored Licensee Clause Has Not Been Settled by This Court.*

This Court has consistently condemned misuse of patents by restrictive licensing practices and failures to disclose critical information to the Patent and Tradmark Office. *Carbice Corp. of America* v. *American Patents Development Corp.*, 283 U.S. 27, 51 S.Ct. 334, 75 L.Ed. 819 (1931); *Leitch Mfg. Co.* v. *Barber Co.*, 302 U.S. 458, 58 S.Ct. 288, 82 L.Ed. 371 (1938); *Morton Salt Co.* v. *G.S. Suppiger Co.*, 314 U.S. 488, 62 S.Ct. 402, 86 L.Ed. 363 (1942); *Mercoid Corp.* v. *Mid-Continent*

1982); *Arco Polymers, Inc.* v. *SGK*, 555 F.Supp. 547 (E.D. Pa. 1982).

Investment Co., 320 U.S. 661, 64 S.Ct. 268, 88 L.Ed. 376 (1944); *Walker Process Equipment, Inc.* v. *Food Machinery and Chemical Corp.*, 382 U.S. 172, 86 S.Ct. 347, 15 L.Ed.2d 247 (1965). The public policy behind the "misuse" doctrine is to prevent anticompetitive practices by the patent owner's abuse of the patent grant. *USM Corp.* v. *SPS Technologies, Inc.*, 694 F.2d 505, 511 (7th Cir. 1982). This is such a case.

Here, there was intentional concealment by the patent owner of the royalty terms in the Ziegler/Diamond license (518 F.Supp. 570). Although such concealment was not characterized by the parties or the courts below as a "misuse" of patent rights by the patent owner, a concealment of information by a patent owner which is required by a "most favored licensee" clause to be disclosed is a misuse for it prevents a licensee from acting with all of the facts before him. It is an abuse of the patenting process when a patent owner is permitted to manipulate his patent rights by concealment when disclosure is required for establishment of cost equality among licensed competitors. The issue is not whether such concealment caused a detriment to any particular licensee in a particular case, although there was definitely a detriment to the Petitioner in this case. Rather, the issue is whether there is a patent misuse when a patent owner intentionally fails in its duty of candor and honesty in dealing with patent rights and their licensing.

Patent rights are granted under the Constitution. As this Court has stated in a number of prior decisions: "The patent is a privilege . . . . which is conditioned by a public purpose." *Mercoid Corp.* v. *Mid-Continent Investment Co.*, 320 U.S. 661, 64 S.Ct. 268, 88 L.Ed. 376 (1944); *United States* v. *Line Material Co.*, 333 U.S. 287, 68 S.Ct. 550, 91 L.Ed. 701 (1948). Where the privilege of a patent is abused by the patent owner's concealment of information relating to licenses, which it is obligated to disclose to its licensees so that they may compete on equal terms, there is a frustration of the public purpose of patents. Such

action is contrary to the public interest and basic elements of fair play.

C. *The Obligation of Full Disclosure in Dealing With Issued Patents is Analogous to the Equitable Doctrine of Candor and Honesty in Obtaining Patents from the United States Patent and Trademark Office.*

This Court held in *Precision Instrument Mfg. Co.* v. *Automotive Co.*, 324 U.S. 806, 65 S.Ct. 993, 89 L.Ed. 1381 (1945), and restated it in *Walker Process Equipment, Inc.* v. *Food Machinery and Chemical Corp.*, 382 U.S. 172, 86 S.Ct. 347, 15 L.Ed.2d 247 (1965), that a patentee has an obligation of full disclosure, candor and honesty in dealing with the United States Patent and Trademark Office in initially obtaining patents.

> "Those who have applications pending with the Patent Office or who are parties to Patent Office proceedings have an uncompromising duty to report to it all facts concerning possible fraud or inequitableness underlying the applications in issue."

By analogy, public policy and public interest require the same type of candor and honesty by a patent owner in the *use* of the patent rights. For example, where patent owners have sought to enforce patents known to be invalid, the courts have condemned it. See, *Kobe, Inc.* v. *Dempsey Pump Co.*, 198 F.2d 416 (10th Cir. 1952), *cert. denied*, 344 U.S. 837 (1952); *Dairy Foods Inc.* v. *Dairy Maid Products Cooperative*, 297 F.2d 805 (7th Cir. 1961); *Kahn* v. *Dynamics Corp. of America*, 508 F.2d 939 (2d Cir. 1974), *cert. denied*, 421 U.S. 930 (1975); *Handgards, Inc.* v. *Ethicon, Inc.*, 601 F.2d 986 (9th Cir. 1979). When the patent owner knowingly conceals vital information from its licensee as Ziegler and SGK did here, the patent owner fails in its obligation of candor and honesty in the use of the patent. In view of the public interest in patents, and their proper use, should there be any lesser standard of candor and honesty for a patent owner in dealing with the patent rights *after* the patent has been granted than this Court requires of the patent owner when obtaining the patent? Certainly, the answer is NO, and most especially when

the duty of candor is a matter of public interest such as consideration bargained for by the patent licensee and which provides competitive cost equality among licensees.

2. The Court of Appeals Improperly Refused to Resolve Disputed Royalty Provisions in the Patent License Agreements Because "[T]hese Constructions Would Place the Court in a Position of an Arbitrator." Since the Fundamental Responsibility of a Court Is to Resolve Disputes in a Manner Akin to Arbitration, the Refusal by the Court of Appeals To Do So Requires this Court's Power of Supervision to Avoid Such a Departure From the Accepted and Usual Course of Judicial Proceedings.

When the Court of Appeals refused to resolve the "Novamont-Ziegler-Hercules situation," its astounding basis for justifying such position was that working out the terms to maintain competitive equality "would place the court in the position of an arbitrator." Since the usual and historical role of courts is to resolve legal and factual disputes, the Court of Appeals should have, at the very least, remanded the case to the District Court for such a resolution — as the Sixth Circuit did in *Shatterproof*. To do less is to leave the parties without an opportunity for judicial relief and to sterilize MFL provisions. Such circumstances properly call into play this Court's power of supervision to prevent such a departure from the necessary and usual role of judicial responsibility.

The Court of Appeals' refusal is particularly egregious here where the patent licensor intentionally concealed some of the terms of later licenses from the MFL holder which created the problem in the first instance. If the Court below had followed the prophylactic rule that candor and good faith demanded that SGK disclose all royalty related terms, then the judgment on whether some terms in the later licenses were more favorable or not would have rested with Petitioner and not the Court. Having failed in its duty, SGK should not now be given the added help of an injudicious determination by the Second Circuit that it will

not meet its responsibilities by deciding the disputed terms of the various agreements or remanding the case for the District Court to do so. Since this is what courts do everyday in determining the respective rights of parties to a license where such licenses do not cover every conceivable contingency, this restrictive view of a court's function leaves even the most prudent licensee at the mercy of its non-disclosing licensor.

The refusal also is in conflict with the Sixth Circuit in *Shatterproof*. By the way of background, for example in the Ziegler/Hercules agreement, lump sum payments were made to Ziegler under that license by Hercules, the heaviest producer in the industry. The total lump sum paid was $1,600,000 (Pet. App. 88). Petitioner's license with Ziegler required a running royalty payment on a percentage basis of the amount of polypropylene sold by Petitioner. Because of such difference in the *type* of royalty payments, the Court of Appeals below declined to even consider what it derogated as "customizing," i.e. whether the lump sum to Hercules as the giant in the domestic industry was more favorable than the running royalty of Petitioner.

This is contrary to the 1974 *Shatterproof* opinion, although supported to some extent by the older Seventh Circuit opinion in *Hazeltine Corp. v. Zenith Radio Corp.*, 100 F.2d 10 (7th Cir. 1938), *cert. denied*, 306 U.S. 656 (1939) which was relied upon by the Court of Appeals below. *Hazeltine* held that:

> "In view of the vital and significant differences between a fixed sum per period rate of royalty and a percentage of selling price rate of royalty we are of the opinion that the two rates of royalty are substantially different types and that there is no basis in fact for the conversion of a lump sum rate of royalty into a rate of per cent of selling price royalty. The former is a true alternative to the latter and must be so treated in determining the rights of Hazeltine and Zenith in respect to royalty provisions under the option contract." 100 F.2d at 18.

This holding — and its philosophy — is in direct conflict with common sense and with the *Shatterproof* case. The latter squarely held that even though the royalty arrangements are different in the two license agreements the question to be determined is whether one was more favorable than the other. *Shatterproof* had this to say (p. 324):

> "Thus, the consideration in each case was certainly different. But the question to be determined is whether one was more favorable than the other. Only by a comparison of the *value* of the consideration given in each instance can it be determined whether Shatterproof is entitled to more favorable rates." (Emphasis added.)

It is clear that there is a conflict in the law applied by the several Circuits that have considered this question. If the law set forth in the *Hazeltine* case and by the Court of Appeals in this case is followed, a patent owner can readily evade MFL clauses merely by providing its licensees with different types of royalty arrangements. Tolerating such a potential subterfuge by patent owners is not good public policy. It should not be permitted by this Court since it makes a travesty of an important type of provision used to maintain competition in the marketplace.

3. The Court of Appeals' Decision is in Conflict with the Decision Of the Sixth Circuit Court of Appeals on the Question of Whether More Favorable Royalty Terms Based on Payments for Past Infringement Must be Considered in Evaluating Equality of Patent License Terms.

The District Court relied upon decisions in one district court case and in two state court cases in reaching its *legal conclusion* that MFL provisions do not apply to the settlement of infringement claims, 518 F.Supp. 570. The cases relied upon by the District Court, *Searle Analytic, Inc.* v. *Ohio-Nuclear, Inc.*, 398 F.Supp. 229 (N.D. Ill. 1975); *Universal Oil Products Co.* v. *Vickers Petroleum Co.*, 41 Del. 238, 19 A.2d 727 (1941); *Raytheon Mfg. Co.* v. *Radio Corporation of America*, 286 Mass. 84, 190 N.E. 1 (1934) are weak support of an ill-conceived position.

The District Court did not cite, and apparently did not consider, the Sixth Circuit decision in *Shatterproof Glass Corp. v. Libby-Owens-Ford Co.*, 482 F.2d 317 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974). The Court of Appeals considered the *Shatterproof* case in a footnote (Pet. App. A-6) but rejected the Sixth Circuit holding on the superficial basis of the "facts of that case" without discussing any factual differences. Indeed, on the threshold issue of a licensee's obligation, it cannot be distinguished. Moreover, if the Second Circuit's position is allowed to stand, it makes most favored nations clauses useless and makes a mockery of the duty of fair and open dealing between licensors and licensees — particularly when a party bargained for such treatment.

Although the facts in the *Shatterproof* case were not identical to the facts in the present case, the facts are clearly comparable on the issue of whether payments for *past* infringement should be considered in evaluating the equality of terms with respect to a most favored licensee clause. In the *Shatterproof* case, Ford paid Libby-Owens-Ford (LOF) $400,000 for a release for infringement prior to January 1, 1961 (482 F.2d 317, 319). The Sixth Circuit, relying on the holding by this Court in *DeForest Radio Telephone & Telegraph Co. v. United States*, 273 U.S. 236, 47 S.Ct. 366, 71 L.Ed. 625 (1927), concluded as a matter of law that settlement by payment of just compensation for previous use of the patent amounted to a license at more favorable terms even though there was some difficulty in the allocation of royalties among different patents. To hold otherwise, in the court's judgment, would "make evasion of a 'favored nations' clause possible." (p. 321). If the decision below is also to stand, such evasion will not merely be possible, it will be inevitable!

In the present case, contrary to the Court of Appeals' attempt to distinguish factually from *Shatterproof*, the facts here are even more compelling in favor of Petitioner. As recognized by the District Court, 518 F.Supp. 570, but ignored by the Court of

Appeals, the payment under the Ziegler/Diamond license for past infringement was to be credited to the payment of royalties due in the future. Thus, even any arguable distinctions between royalties paid for past infringement or a future license do not apply in this case. The Court of Appeals had no basis for failing to carry out its judicial responsibility, which it did when it refused to consider whether the payment of $750,000 by Diamond to Ziegler should have been credited to Petitioner to make the terms between the two licensees equal.

The *DeForest* case decided by this Court determined that payments for past infringement effectively constituted a license under the patent. However, this Court has not settled the question of important federal law which should be settled, namely, whether all royalty payments including payments for past infringement should, as a matter of law, be considered in evaluating equality of royalty terms in different licenses. In view of the conflict between the Court of Appeals for the Second Circuit in this case and the Court of Appeals for the Sixth Circuit in the *Shatterproof* case, that issue is in conflict. So long as that issue remains unsettled, it will foster litigation among patent owners and licensees and reduce the level of candor by parties on both sides of the issue. Although the settlement of past infringement is a desirable goal, the use of past infringement settlements by a patent owner to evade a bargained-for commitment to equality among licensees-competitors is bad public policy and should not be the law of the land.

4. **The Court of Appeals compounded the error of its departure from the accepted and usual role of judicial responsibility in not only refusing to resolve the issue of equal royalty treatment, but also by placing the burden of proof as to the more favorable terms on the MFL holder instead of on the patent owner who granted the subsequent licenses.**

As held by the Sixth Circuit in *Shatterproof Glass Corp. v. Libby-Owens-Ford Co.*, 482 F.2d 317, 324 (6th Cir. 1973), *cert. denied*, 415 U.S. 918 (1974), the burden of proof is initially on

the licensee which has the most favored nations clause to show a breach of the contract by the patent owner. Once that has been shown, it would be an "unfair and unrealistic burden" to require the licensee to *prove* that other licensees were given more favorable royalty terms. As the Court there stated (p. 324):

> "The ordinary rule, based on considerations of fairness, does not place the burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary." *United States* v. *New York, New Haven & Hartford R.R.*, 355 U.S. 253, 256 n. 5, 78 S.Ct. 212, 214, 2 L.Ed.2d 247 (1957); *United States* v. *Hayes*, 369 F.2d 671, 676 (9th Cir. 1966); *Erving Paper Mills* v. *Hudson Sharp Machine Co.*, 332 F.2d 674, 678 (7th Cir. 1964), *cert. denied*, 379 U.S. 946 (1964).

Under this rationale, after the licensee carried its burden by showing a breach, the Sixth Circuit placed the burden of proof on the patent owner to show that the later licensee was not given a license on more favorable terms than the first licensee.

In the present case, the Court of Appeals implicitly placed the burden of proof on Petitioner to show that there was a breach *and* that the later licenses were more favorable. Even with that improperly placed burden, Petitioner satisfied the Court of Appeals that the Ziegler/Diamond license was more favorable than Petitioner's license, 704 F.2d 48, n.5, yet the court still denied Novamont its requested relief. With respect to the Ziegler/Hercules license, however, the District Court's requirement that Petitioner Novamont had to show "by a preponderance of the evidence" that the Hercules license had more favorable terms, (Pet. App. B-38), was implicitly adopted by the Court of Appeals when it held that such finding was not clearly erroneous (Pet. App. A-19). Thus, the Court of Appeals for the Second Circuit placed the burden of proof on Petitioner contrary to the ordinary rule of fairness referred to and adopted by the Sixth Circuit in its holding in the *Shatterproof* case in a similar type of situation.

Conclusion

For each of the foregoing reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Second Circuit.

Respectfully submitted,

. . . .

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September 1, 1983

CERTIFICATE OF SERVICE

I hereby certify on this .... day of September, 1983, three copies of this Petition for Writ of Certiorari were mailed, via first class mail, postage prepaid, to Sprung, Horn, Kramer & Woods, 600 Third Avenue, New York, New York 10016. I further certify that all parties requiring to be served have been served. This modified Petition has been submitted as a substitute for the one filed with the Court on September 1, 1983.

....

James B. Gambrell
Attorney for Petitioner

APPENDIX A

STUDIENGESELLSCHAFT KOHLE m.b.H.,
Plaintiff-Appellee-Cross-Appellant,

v.

NOVAMONT CORPORATION nna.,
U.S.S. Novamont Incorporated,
Defendant-Appellant-Cross-Appellee.

Nos. 397, 398, Dockets 82-7143, 82-7163.

United States Court of Appeals,
Second Circuit.

Argued Oct. 13, 1982.

Decided March 28, 1983.

Before MESKILL, PIERCE and FAIRCHILD*, Circuit Judges.

FAIRCHILD, Circuit Judge.

These appeals involve the interpretation and application of a "most favored licensee" (MFL) clause in a patent license agreement. Studiengesellschaft Kohle m.b.H (SGK), the owner of the patent, sued Novamont Corporation to recover royalties due under a license agreement dated July 1, 1974. Novamont counterclaimed, claiming breaches of the MFL clause in the previous license agreement between the parties dated January 1, 1967, and fraud in the negotiation of the 1974 agreement. The facts appear in detail in the opinion and findings of the district court, *Studiengesellschaft Kohle v. Novamont Corp.*, 518 F. Supp. 557 (S.D.N.Y. 1981).[1]

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* Honorable Thomas E. Fairchild, United States Senior Circuit Judge for the Seventh Circuit, sitting by designation.

[1] Jurisdiction is founded on diversity. All parties appear to have assumed that New York law controls substantive questions.

In the 1967 agreement, Ziegler, the original patentee, granted Novamont a non-exclusive license to produce certain polymers of propylene under United States Patent No. 3,113,115 (the '115 patent). Thereafter Ziegler brought action charging Phillips Petroleum Company with infringement. On June 23, 1971, the district court found no infringement.[2] Presumably because of the district court judgment, Novamont gave notice July 9, 1971 that it would discontinue payment of royalties. On March 24, 1972 Ziegler gave notice of cancellation of Novamont's license.

On July 1, 1974, after decision on appeal reversing the district court judgment, upholding the validity of the patent, and finding infringement, Novamont and SGK, Ziegler's successor, reached agreement (*see* 518 F.Supp. at 568), creating the new license agreement sued upon here by SGK and providing that the 1967 agreement would remain in full force and effect notwithstanding notice of termination and that Novamont would pay all past due royalties under the 1967 agreement, with interest. *See* 518 F.Supp. at 568.

The district court concluded, 518 F.Supp. at 569, that the 1974 agreement restored the position of Novamont under the 1967 agreement and that it could enforce its MFL clause with respect to events during its periods of alleged infringement. We examine the interim events as consistently as possible with the continued vitality of the 1967 agreement.

The 1967 MFL clause, Article IX, paragraph A.1, imposed a duty upon Ziegler promptly to furnish Novamont with the full text of the royalty provisions of any license granted by Ziegler under the '115 patent if such royalty provisions, considered in their entirety, are more favorable than those in the 1967 Novamont Agreement. Paragraph A.2 gave Novamont the right "upon written request within ninety (90) days after receipt of

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[2] Ziegler was successful on appeal in 1973. *Ziegler v. Phillips Petroleum Company*, 483 F.2d 858 (5th Cir.), *cert. denied*, 414 U.S. 1079, 94 S.Ct. 597, 38 L.Ed.2d 485 (1973).

the aforesaid full text of such other license from Licensor, to substitute for the entirety of this Agreement all of the provisions of such other license."[3]

On July 9, 1970 Ziegler granted a license to Diamond Shamrock Chemical Company (Diamond). One of the principal controversies upon appeal is whether a simultaneous, undisclosed agreement between Ziegler and Diamond concerning past infringement was required to be disclosed, and included in a substitute agreement between Ziegler and Novamont if Novamont so elected. A second, though minor, controversy is whether another undisclosed agreement giving Diamond an option to expand its license to include copolymers of propylene was subject to similar requirements. A third controversy is whether Novamont was and is entitled to the benefit of a provision for accrual of royalties similar to the accrual permitted to Diamond in its 1970 agreement with Ziegler.

On April 26, 1972 Ziegler made a new agreement with Hercules Powder Company, amending previous license agreements and granting "a fully paid-up immunity from suit" until the expiration of the '115 patent. A fourth controversy is whether Novamont was entitled to a prepaid license computed on a similar basis but tailored to a much smaller amount of production.

Finally, Novamont asserts misrepresentation and nondisclosure concerning these agreements with the other parties, amounting to fraud.

I. The Undisclosed Agreement With Diamond Concerning Past Infringement

Ziegler did not initiate disclosure to Novamont of the 1970 agreement with Diamond. Only in part were the royalty provisions more favorable than Novamont's. The royalty rates in the

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[3] The full text of the MFL clause is set forth in 518 F.Supp. at 565.

Diamond agreement were lower than those in the 1967 Novamont agreement. On the other hand the Diamond agreement required a $200,000 down payment, did not permit the deduction of royalty payments to third parties, and granted no right to suspend royalty payments if infringers were not prosecuted.[4] In any event, Novamont learned about the Ziegler-Diamond agreement, demanded to be informed, and Ziegler, on October 30, 1970 supplied Novamont with the document which granted the license to Diamond. Novamont did not request substitution under paragraph 2 of the MFL clause. Ziegler also disclosed a part of a separate letter, although it did not disclose the paragraph which agreed that in the event of recovery by Ziegler for Diamond's past infringement "such recovery shall additively be credited to the down-payment made in accordance with Paragraph III of the license agreement in the same manner as if the same had initially constituted part of the down-payment actually made, and shall be credited against royalties as provided in the license." 518 F.Supp. at 566. Paragraph III(a) required Diamond to pay $100,000 within 30 days, $50,000 more within one year, and $50,000 more within two years. The entire $200,000 was non-returnable except that it could be credited against royalties up to 50% of the royalties in any one year.

Novamont contends that the undisclosed 1970 paragraph was a royalty provision because it should be viewed as providing for a

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[4] Because of our conclusion, consistent with that of the district court, that Novamont was entitled by its MFL clause to the benefit of an Accrual of Royalties provision similar to that contained in the 1970 Diamond licensing agreement, we conclude that the royalty provisions of the Diamond agreement, considered in their entirety, are more favorable than those in the 1967 Novamont agreement. It follows that the MFL Clause required disclosure of the royalty provisions even though some of the provisions were less favorable. The same conclusion is implicit in the district court opinion previously cited, 518 F.Supp. at 571-572, and was made explicit in an unpublished opinion denying SGK's post-trial motions.

reduction in royalty. In any event, says Novamont, the undisclosed paragraph must be deemed part of the licensing agreement, and since the royalty provisions as a whole were more favorable, the MFL clause entitled Novamont to an agreement which included the undisclosed paragraph. Obviously the undisclosed paragraph was not likely to be significant until the final outcome of the *Phillips* litigation over the '115 patent, but on May 6, 1974, after final decision in the *Phillips* case, Ziegler released Diamond from liability for infringement before July 1, 1970 in return for a payment of $750,000, credited as agreed. The terms of the 1974 settlement were not disclosed to Novamont.

[1] It is clear that the terms of the undisclosed paragraph, taken literally, could not have benefited Novamont because Novamont had not then been an infringer. To be of benefit to Novamont the MFL clause would have to be so broadly construed as to call for modification in addition to substitution of the terms of the new agreement. Novamont evidently reasons that the MFL clause must be construed so as to entitle it to enjoy a credit against royalties equivalent in substance to the credit given Diamond for the sums paid for infringement. Novamont argues that the equivalent credit would be the amount paid by Diamond, $750,000, or at least the aggregate royalty Novamont had paid during the period Diamond had been infringing, some $465,000.

SGK contends that its agreement in 1970 to apply the amount recovered for infringement to royalties (as well as its acceptance of $750,000 in settlement for infringement) relates to past infringement, and is not a royalty provision of its new license agreement. SGK emphasizes that it did not wholly forgive the past infringement because the interest cost to Diamond of the $750,000 advance payment was substantial (allegedly about $354,000). But SGK contends that whatever discount it afforded

Diamond in the settlement of claims for infringement was irrelevant to the MFL clause.

The district court decided this issue in favor of SGK, correctly, we think.

Other cases have involved a similar tension between treatment of an earlier licensee, who was entitled to the protection of an MFL clause, and a competitor who takes a license later, after a period of infringing activity. Arguably, parallel treatment would require not only that royalty terms be the same from the grant of the second license forward, but that the licensor must insist upon an exaction from the later licensee for past infringement which is equivalent to the royalty terms governing the earlier licensee during the same period, or must make a refund to the earlier licensee.

MFL clauses do not seem to have been drawn so as to compel that degree of equivalency and the courts which have dealt with the situation have declined to interpret the clauses with that breadth. *Raytheon Mfg. Co.* v. *Radio Corporation of America,* 286 Mass. 84, 190 N.E. 1,5 (1934); *Universal Oil Products Co.* v. *Vickers Petroleum Co.*, 41 Del. 238, 19 A.2d 727, 729 (1941); *Rothstein* v. *Atlanta Paper Co.,* 321 F.2d 90, 96 (5th Cir. 1963); *Searle Analytic, Inc.* v. *Ohio-Nuclear, Inc.*, 398 F.Supp. 229 (N.D.Ill. 1975).[5]

The district court relied on these decisions, and we agree.

II. The Undisclosed Copolymer Option

[2] Simultaneously with the 1970 license agreement and the undisclosed agreement concerning past infringement, Ziegler

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[5] Novamont cites *Shatterproof Glass Corp.* v. *Libbey-Owens-Ford Co.*, 482 F.2d 317, 321 (6th Cir. 1973), *cert. denied,* 415 U.S. 918, 94 S.Ct. 1417, 39 L.Ed.2d 473 (1974). The court determined under the particular facts of that case that the release from claims of past infringement "was in effect a settlement by payment of just compensation for previous use of the patent" and had the effect of a retroactive license. We are not similarly persuaded here.

and Diamond made a separate Option Agreement. Diamond paid $20,000 on execution of the Option Agreement. The agreement gave Diamond the right upon payment of an additional $30,000, to have the license amended to include manufacture, use and sale of certain propylene copolymers, subject to the same obligation to pay royalties. Both payments were non-returnable except that they would be credited against royalties.

The Option Agreement was not disclosed to Novamont. The option was never exercised by Diamond. Novamont already had the right to produce the copolymers under its 1967 agreement.

Novamont devotes little of its appellate argument to its claim that nondisclosure of the Option Agreement violated its MFL clause. We think the district court correctly denied this claim. 518 F.Supp. at 569.

III. The 1970 Diamond Provision for Accrual of Royalties

The 1970 licensing agreement between Ziegler and Diamond contained a paragraph entitled "Accrual of Royalties," which provides as follows:

> Licensee may hold and accrue royalties without forwarding the same to Ziegler during any period during which Ziegler is engaged in a suit for patent infringement involving the process utilized by Licensee and being defended by a party under a contractual obligation to hold Licensee harmless. Licensee, however, shall continue to account to Ziegler during such period of accrual and promptly upon termination of such suit shall pay accrued royalties to Ziegler, after deduction of any applicable credits, if, as a result of such suit, it is adjudged that Licensee's process infringes any valid claim of a patent owned by Ziegler and litigated in said suit, or if Licensee does not cancel this License as provided hereinafter. If, as a result of such suit, it is not adjudged that Licensee's process infringes any valid claim of a patent owned by Ziegler and litigated in said suit,

Licensee, may by written notice, advise Ziegler of cancellation of this License. Upon such cancellation, Licensee shall be subject to any action in law or for which would have been or is available to Ziegler in absence of this License, including action for past infringement during the period that royalties were not paid. Licensee will have the benefits of any settlement reached by and between Ziegler and any third party contractually obligated to hold Licensee harmless.

The first sentence causes the Accrual of Royalties provision to apply to Diamond during the pendency of the *Phillips* litigation because Phillips had agreed to hold Diamond harmless. If the identical provision were included in a Novamont license, it would not apply to and benefit Novamont. Hence SGK claims that the Accrual of Royalties provision is irrelevant to the operation of Novamont's MFL Clause.

[3] The district court reasoned, however, that giving literal effect to the tailoring in this fashion of a beneficial royalty provision so that it would not benefit a licensee who is entitled to the protection of an MFL clause would be an evasion of the intention of the parties to the clause. 518 F.Supp. at 571. We agree.

We note SGK's argument that Diamond had little incentive to take a license so long as it enjoyed the protection of the *Phillips* hold-harmless agreement. SGK may well have been correct that the Accrual of Royalties provision was necessary in order to obtain Diamond's agreement. That proposition, however, is beside the point in determining the proper impact of the MFL clause. It is likely to be generally true that a licensor's grant of more favorable terms is supported by a sound business reason, but the benefit of more favorable terms is exactly what the person whose license includes an MFL clause has bargained for and to which he is entitled.

The purpose of the MFL clause was to protect Novamont from a competitive disadvantage resulting from more favorable

terms granted to another licensee. *Prestole Corporation* v. *Tinnerman Products, Inc.*, 271 F.2d 146,152 (6th Cir. 1959). Limitation to Diamond of the right to accrue and delay payment of royalties during the infringement litigation would give Diamond a competitive advantage over Novamont. The fact that Diamond would have been held harmless if it continued to infringe rather than take a license is not germane to any purpose of the MFL clause. In a sense the limiting language helps identify the *Philips* litigation as the suit the parties had in mind, but for any other purpose the MFL clause requires the limiting language to be disregarded. We think Novamont's MFL clause entitled it to substitute the entire Diamond license agreement, including a right to accrue royalties under the provision, as long as the *Phillips* litigation continued.

[4] We are more troubled, however, by Novamont's failure to make a written request for substitution of all the provisions of the Diamond license within ninety days after being supplied with its provisions on October 30, 1970.

Novamont made no such written request until August 26, 1977, shortly before SGK brought this action for unpaid royalties under the 1974 agreement. Novamont had then learned of the undisclosed agreements and its counsel wrote SGK's counsel adopting the provisions of the Diamond license, including the undisclosed agreements. Even in that letter there was no specific reference to a claim that Novamont was entitled to enjoy the benefit of the Accrual of Royalties provision.

The district court, however, found that at a meeting on November 6, 1970, Ziegler's representatives refused to grant Novamont the right to accrue, rather than pay, the royalties due during the period of the *Phillips* litigation. 518 F.Supp. at 566. Addressing the point in an unpublished opinion on post-trial motions, the court said, in part, "Novamont did attempt to secure the right to accrue during its negotiations with Ziegler. Based on the response it received during those negotiations,

Novamont could reasonably have concluded that the submission of a formal written request would have been an exercise in futility."

For evidence on the point, the parties have cited two memoranda from the Novamont side.

One refers to the November 6 conference. It lists provisions of the Diamond agreement, some less favorable than Novamont's existing license, and some more favorable, including "the right not to pay" during the infringement litigation. The Novamont position is stated: "Novamont wants a new agreement assuring it some benefits comparable to those given by the new Ziegler/Diamond Agreement." The Ziegler position is stated: "Prof. Ziegler's representatives contested such a right of Novamont. They were willing to allow Novamont to get the lower rates existing in the Diamond Agreement, but with the obligation to continue royalty payments."

The second memorandum is dated November 13, 1970 and appears to be a report on a "recent conference." It contains a reference to the provision for accrual: "The present contract offered to Diamond is tailored to Diamond, since it provides that there will be no payments as long as there is another company, holding the licensee harmless. The attitude of the Germans seemed inflexible."

The proof is less than clear that Novamont offered to take all the other provisions of the Diamond agreement, favorable and unfavorable, if it could have the accrual right. Nevertheless, we might well consider the district court finding not clearly erroneous if the matter stopped there.

There is, however, a further question whether Novamont's claim to be entitled to the Diamond license provisions, including

accrual, survived the July 1, 1974 agreement between Novamont and Ziegler. We conclude that it did not.[6]

SGK claimed that the July 1, 1974 agreement constituted an accord and satisfaction. In the unpublished opinion on post-trial motions, the district court stated that SGK had not carried its burden. "There is no evidence in the record of any express statement by either of the parties, either during the negotiations leading up to the 1974 agreement, at the time it was entered into, or in the agreement itself, that the agreement was intended to constitute an accord and satisfaction."

The agreement, 518 F.Supp. at 568, did provide that it was made "in order to settle the differences between the parties." It is true that in its recitation of disagreements there was no mention of dispute over Novamont's right to substitute the provisions of the 1970 Diamond license. It did provide that the 1967 Novamont Agreement "remains in full force and effect" and that Novamont shall immediately account for and pay, with 10% interest, all past due royalties under the 1967 agreement. These agreements are flatly inconsistent with any claim that Novamont's royalty obligations were governed by the Diamond Agreement. The agreement to pay interest was completely at war with any application to Novamont of the accrual provisions. In our view the parties' intent to merge those claims in the settlement was so clear that some express reservation of them would have been necessary to avoid that result.

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[6] SGK contends that because the counterclaim was filed October 24, 1977, the claim for the benefit of the Accrual provision was in any event barred by the six year statute of limitations. Novamont asserts that certain events tolled the running of the statute. The district court was under the impression that although SGK had pleaded the statute of limitations, SGK had abandoned that defense "in its pretrial order." On appeal SGK cites language from the order which appears to preserve all issues raised by the pleadings, and Novamont has cited no provision indicating abandonment. In view of our disposition of this claim, we do not reach the limitations issue.

The district court erred in awarding an offset to Novamont based on the accrual provisions.

IV. The 1972 Hercules Pre-Paid License

Ziegler had licensed Hercules in 1954, and their agreement had been amended in 1962 and 1964. 518 F.Supp. at 562. It provided for "running" royalties as did Novamont's, *i.e.*, rates applied to amounts of sales. The Hercules rates were somewhat lower than Novamont's, but this was irrelevant with respect to Novamont's MFL clause because the Hercules license existed before the 1967 Novamont license, and the MFL clause applied only to licenses granted during the life of the agreement.

As already noted there came to be alleged infringement of the '115 patent by Phillips and others. On that account Hercules suspended royalty payments as of April 30, 1970. It claimed the right to do so under a provision of its license.

On April 26, 1972, Ziegler and Hercules reached a new agreement, 518 F.Supp. at 563. Paragraph 5 granted Hercules a "fully paid-up immunity from suit until December 3, 1980." The "immunity from suit" has been treated as the equivalent of a license extending to the expiration of the '115 patent. The license was pre-paid for a quantity of 600 million pounds per year sales, and a 1% royalty was to be paid on any excess. Other provisions required Hercules to make immediate non-refundable payments totalling $800,000, and an additional payment of $800,000, with interest from May 1, 1972, contingent upon a favorable decision on the validity of the '115 patent in the *Phillips* litigation.

Literally Paragraph 1 called for immediate payment of $770,000 in settlement of unpaid royalties from April 1, 1970 through 1972. Paragraph 2 called for immediate payment of $30,000 plus the contingent $800,000 for immunity from suit after 1972. The district court found, however, that the division was artificial, made for the tax purposes of Hercules and did not

represent the actual agreement. "The actual agreement called for a full $1.6 million down-payment in the event that Ziegler was successful in the *Phillips* action, which down-payment was entirely directed toward future production, rather than partially directed toward past infringement." 518 F.Supp. at 572.

On appeal, Novamont contends that the $770,000 represented a total of Hercules' suspended royalties from April 1, 1970 to December 31, 1971, plus the then present value of Hercules' expected royalty for the year 1972, rounded off by a discount of .22%, and that the $830,000 represented the then present value of Hercules' expected royalty for the years 1973 through 1980, but reduced by a very substantial discount of 55.71%.

Novamont argues that its MFL clause entitled it in 1972 to a prepaid license covering its desired production of 160 million pounds per year. The lump sum pre-paying 1972 to 1980 would be computed by employing Novamont's (or as it says, Diamond's) royalty rates, sales of 160 million pounds each year, and the same discounts used in the Hercules computation. Unpaid royalties since 1971 would be treated in a similar manner to Hercules' suspended royalties. Presumably the total lump sum would have been divided into a required payment and a contingent payment, although by hindsight we know that the contingency was fulfilled. In other words, Novamont contends its MFL clause gave it the right to a "customized" prepaid license, with a lump sum royalty equivalent to the Hercules lump sum royalty, except for the difference in production. It now claims to be entitled to an adjustment which would put it in the same position as if it had made an agreement on that basis in 1972.

Ziegler points out that Novamont pursued a different theory at trial, and did not urge the significance of the $770,000 figure in Paragraph 1 of the Hercules agreement. Indeed Novamont proposed a finding, similar to the district court's, that the "$770,000 was, for tax purposes, attributed to payment of royalties from April 1, 1970 to December 31, 1972." In its amended

complaint, Novamont had alleged that the Hercules agreement was a paid-up license for $1.6 million. Unlike the district court findings, and unlike its present theory, it proposed a finding that the $1.6 million lump sum represented 75% of Hercules' suspended royalties, plus approximately 75% of the projected royalties through 1977, according Hercules free royalty for the last three years of the life of the patent.

As we understand the SGK version, it was that Hercules prepared a projection of sales, based on plant expansion and increased production. Price trends were projected. There was a reduction of approximately 20% for contingencies in the course of planned plant expansion. If and when sales exceeded 600 million pounds in any year, royalty on the excess would be 1%. The $1.6 million represented the 1972 present value of royalties at the previous Hercules rate on the estimated future sales up to 600 million pounds per year.

[5] The district court found that Novamont failed to establish that a three year forgiveness was embodied in the agreement or that a method was used to reach the Hercules agreement different from that used in an offer made to Novamont. 518 F.Supp. at 574. If essential for the purpose of this decision, we are unable to say that the finding is clearly erroneous.

We conclude, however, that Novamont's MFL clause did not entitle Novamont to this analysis.

If we assume Novamont was right in either the analysis on which it proceeded at trial, or the one which it argues here, Novamont's position would rest upon an untenably broad construction of its MFL clause, albeit a construction which the district court seemed willing to entertain. 518 F.Supp. at 573-574.

Moreover on the facts before us Novamont's success would require a retrospective hypothetical reconstruction which presents serious difficulties. At the time of the 1972 Hercules agreement, Hercules had not been paying royalties for two

years, claiming a contractual right to suspend because of infringement by others. Hercules was willing to pay $800,000 down in order to secure a pre-paid license covering 600 million pounds annually, promising an additional $800,000 if the *Phillips* litigation turned out so as to sustain validity. Hercules did not know what that outcome might be, but its willingness to pay $800,000 down must have been affected by its judgment of the probabilities in the *Phillips* case.

Novamont had not paid royalties for most of one year. Ziegler had given notice of termination and viewed Novamont as an infringer. Novamont did not desire a license covering more than 120 to 160 million pounds per year. Its assessment of the *Phillips* probabilities would affect its willingness to accept particular terms. There is nothing to show what terms it would have agreed to, although we know it did not agree to a pre-paid license for $1.6 million, one-half down and one-half contingent on a favorable outcome in *Phillips*.

The unavoidable uncertainty as to Novamont's assessment in 1972 of the *Phillips* outcome may itself be a reason for concluding, contrary to the district court, that in 1974 when the parties used the language "remains in full force and effect and is uncancelled" they did not intend a reconstruction of their liabilities as if the MFL clause had been in force and availed of at the time of the 1972 Hercules agreement.

Assuming that they so intended, however, Paragraph 1 of the MFL clause requires that licensor shall furnish the full text of the royalty provisions of the second license. Under a natural reading of the term "royalty provisions," Paragraph 1 was substantially fulfilled when Ziegler informed Novamont that the Hercules lump sum royalty for 600 million pounds a year was $1.6 million, one-half payable immediately, and one-half on a favorable *Phillips* decision on validity.

The natural reading of Paragraph 2 of the MFL Clause gave Novamont the right, upon written request within ninety days, to

a pre-paid license for the same lump sum, and quantity similarly payable. Under that reading Novamont's failure to make a request ended the matter. Novamont would contend, however, for a construction permitting it to take a pre-paid license for the quantity of its choice based on such similar or comparable considerations, components, and methods of computation so that the royalty provisions could be deemed equally favorable. Presumably there would be some difficulty in achieving equality. For examply, it appears that one of the considerations in computing the Hercules lump sum was an assessment of the probability that it would achieve the production it planned. Although the license authorized 600 million pounds annually the probability that Hercules would reach that level may well have been different from the probability that Novamont would reach the level it chose.

The district court suggested that the term "all of the provisions of such other license" can mean "all of the provisions pertaining to the method by which the lump-sum payment . . . was calculated." 518 F.Supp. 573. Really to complete the thought, it would be necessary to construe Paragraph 2 so as to entitle the Licensee to substitute for his license "all of the provisions of such other license, including, where the other license is a license for a specified quantity, to be prepaid by a lump sum, a provision for a prepaid license for a quantity chosen by the Licensee in return for a lump sum calculated by the methods by which the lump sum was calculated for the quantity specified in the other license."

If "all of the provisions" in Paragraph 2 be so construed, it would seem to follow that "royalty provisions" in Paragraph 1 should be similarly construed, so that the licensor would have been obligated to supply all the information concerning the method of calculation. "Method" in each case would have to include the assumptions to which the mathematical computations were applied.

With all respect, these construction seem overstrained. Because of imponderables which seem to have been involved in the Novamont-Ziegler-Hercules situation, and would frequently be involved in working out terms which would maintain competitive equality, these constructions would place the court in the position of an arbitrator.

We are unaware of any New York decision to give us guidance as to New York law on the point, and of a decision of any court which would support this extent of departure from ordinary meaning of the contract language. Moreover, the two decisions which deal with somewhat related problems counsel closer adherence to the ordinary meaning.

In *Hazeltine Corporation v. Zenith Radio Corporation*, 100 F.2d 10 (7th Cir. 1938), *cert. denied*, 306 U.S. 656, 59 S.Ct. 646, 83 L.Ed. 1054 (1939), Zenith was found to be entitled to a standard license under which the royalty rate was 3% of selling price of some items and 1½% of others. Alternatively each licensee could elect to pay $150,000 per year for an unlimited volume. Zenith also had the benefit of what amounted to an MFL agreement that "the rate of royalty specified in [its] license shall be as low as the lowest rate of royalty specified in any other license." *Id.* at 12. Zenith contended that because a large producer electing the lump sum royalty per year could achieve a percentage rate per unit lower than the 3% or 1½%, the MFL agreement entitled Zenith to the lowest percentage rate so achieved.

In deciding against Zenith on this claim, the court said:

> In view of the vital and significant differences between a fixed sum per period rate of royalty and a percentage of selling price rate of royalty we are of the opinion that the two rates of royalty are substantially different types and that there is no basis in fact for the conversion of a lump sum rate of royalty into a rate of per cent of selling price royalty. The former is a true alternative to the latter and

must be so treated in determining the rights of Hazeltine and Zenith in respect to royalty provisions under the option contract.

100 F.2d at 18.

The shoe was on the other foot in *Cardinal of Adrian, Inc. v. Amerock Corp.*, 208 U.S.P.Q. 822 (E.D.Mich.1979), affirmed by unpublished order, 698 F.2d 1218 (6th Cir. 1982). The licensor granted a new licensee (Weiser) a pre-paid license (with no limit on quantity) for $84,000. Amerock, an existing licensee, sought a pre-paid license for $84,000 under its MFL clause. The licensor argued that Amerock produced a much larger quantity and offered a license at Weiser's effective rate per unit. Then Chief District Judge Kennedy, now Circuit Judge, declined the construction Cardinal wanted, converting, a pre-paid lump sum royalty into an equivalent per unit royalty, saying that Weiser had purchased the right to make as many units as it wanted, and Amerock was entitled to the same right for the same lump sum royalty.

It should be noted that the customizing contended for in those cases would have required only a simple mathematical computation, and not the assumptions and estimates required here.

We decline to construe the MFL clause as entitling an MFL licensee to the type of customizing of the royalty provisions of the second license sought by Novamont.[7]

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[7] We are mindful of our holding that Novamont's claim to substitution of Diamond's 1970 license provisions did not survive the 1974 Novamont/Ziegler Agreement. Although the facts giving rise to Novamont's claim to provisions equivalent to the Hercules pre-paid license also occurred before 1974, Novamont was allegedly unaware in 1974 of some of the facts which were critical to its theory, and we do not rest our decision with respect to the Hercules license on the 1974 Agreement.

V. Claims of Fraud

In part, Novamont bases its claim of fraud on Ziegler's nondisclosure of the paragraph of the 1970 letter to Diamond promising that recovery for past infringement would be additively credited to the down payment under the 1970 Diamond license; on nondisclosure of the 1970 copolymer option granted to Diamond; and on several statements by Ziegler representatives in 1971 which may have artfully led Novamont's people to believe that Ziegler would exact more substantial damages from Diamond for past infringement than Ziegler truly did and that there were no agreements with Diamond other than those disclosed to Novamont.

We have concluded, as did the district court, that Novamont's MFL clause did not entitle Novamont to information on these subjects nor to the benefit of the undisclosed agreements. 518 F.Supp. at 576-76. It follows that these nondisclosures and allegedly misleading statements did not constitute fraud on Novamont with respect to its enforcement of its MFL rights.

In further part, Novamont bases its claim of fraud on Ziegler's refusal to furnish the full text of the 1972 Hercules agreement and on allegedly false representations on the discounts allowed in arriving at the $1.6 million lump sum for the Hercules pre-paid license. In particular the 20% so called contingency discount was not disclosed. The district court found that there was no misrepresentation in characterization of the lump sum payment and that Novamont failed to establish knowing misrepresentation of the manner of calculation of the lump sum. 518 F.Supp. at 575-76. We do not consider these findings clearly erroneous.

In any event we have concluded that Novamont's MFL clause did not entitle Novamont to information as to the method of calculation of the lump sum nor to the benefit of a customized pre-paid license for a different quantity.

[6] Novamont appears to argue that, apart from any effect on its MFL rights, the nondisclosures and alleged misrepresentations fraudulently induced Novamont to make the July 1, 1974 agreement with SGK on which this action was brought. Novamont contends that the fraud provided a complete defense and a basis for punitive damages.

The district court did not deal with this argument, either in its published opinion after trial, 518 F.Supp. 557, nor in its unpublished opinions on post-trial motions. In view of the care with which the court dealt with the issues, this point may not have been urged with much force.

Novamont and Ziegler carried on negotiations from time to time from the fall of 1970 until July 1, 1974 after the appellate decision in the *Phillips* case, when the existing agreement was signed. Shortly before that, Novamont became aware of the full text of the Hercules agreement, previously denied it.

We can understand that if Novamont had been aware of the terms of the infringement settlement with Diamond, Novamont would have included that treatment in its arguments during the course of negotiations. In that general sense the information may be considered material.

Novamont has failed, however, to point out that the treatment of Diamond or Hercules in these respects is material to any provision of the 1974 agreement, or that Novamont relied to its detriment on any misconception of these facts in making the agreement.

Insofar as the judgment awarded Novamont damages on its counterclaim and provided that each party shall bear its own costs, it it reversed, and the cause remanded with directions to restore the full award to plaintiff, without offset, and to reconsider the matter of costs in the light of the outcome of these appeals. In all other respects, the judgment is affirmed. Plaintiff shall recover its costs on appeal.

APPENDIX B

STUDIENGESELLSCHAFT KHOLE mbH,
Plaintiff,

v.

NOVAMONT CORPORATION
Defendant,

v.

MAX-PLANCK-INSTITUT FUR KOHLENFORSCHUNG, Dr. Med. Marianne Witte and Dr. Erhart Ziegler, heirs of Maria Ziegler, and Wilhelm Schmidtmann, Executor of the Estate of Maria Ziegler, Additional Defendants on Counterclaim.

No. 77 Civ. 4722 (RWS).

United States District Court,
S. D. New York.

June 30, 1981.

OPINION

SWEET, District Judge.

This is a diversity action brought by the plaintiff, Studiengesellschaft Kohle m.b.H. ("SGK"), a West German Corporation, against the defendant Novamont Corporation, a Delaware Corporation, now known as U.S.S. Novamont, Inc. ("Novamont"), for royalties allegedly due and unpaid since March of 1977. These royalties are said to arise under a July 1, 1974 agreement licensing certain propylene patent properties owned by SGK, including U.S. Patent 3,113,115 (the "'115" patent.[1] Novamont counterclaimed for compensatory and punative damages arising out of the alleged breach by SGK of the

[1] SGK in its complaint alleged violations of its '115 patent without identifying any particular plant where the violations were said to occur. At the outset of the trial, the parties noted an additional aspect to their dispute. SGK noted that all its discovery and proposed evidence related to the activities of Novamont at its Neal, West Virginia, plant, and that certain information indicated the

most favored licensee clause ("the MFL clause") of the Novamont-SGK license agreements. A summary judgment motion on behalf of SGK was denied, other pretrial proceedings were had and the action was tried to the court on February 1, 13, 17 and 20, 1981.[2]

Post trial briefs and proposed findings of fact and conclusions of law were submitted on March 18, 1981, by skilled and learned counsel for both parties who throughout these proceedings provided great assistance to the court in its exploration of the intricacies of the licensing of a valuable and important patent. On the basis of all these proceedings, as set forth below, I conclude that SGK is entitled to judgment granting certain of the relief which it seeks and dismissing all but one aspect of Novamont's counterclaims against the Max-Planck-Institute fur Kohlenforschung ("MPI") and Dr. Med. Marianne Witte and Dr. Erhart Ziegler ("the heirs") and Wilhelm Schmidtmann ("the Executor").

Findings of Fact

Background of the Patent, its Holders and its Licensing

Professor Karl Ziegler ("Ziegler"), who died in 1973, was an organic chemist and served as the director of MPI in Mulheim, Germany in the early 1950's. MPI is a world renown basic

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possibility its patent might be infringed by the production of Novamont's LaPort, Texas plant. The parties were unble to stipulate in advance as to the res judicata effect, or lack of it, of the judgment to be entered on this opinion. No facts were adduced in this action concerning the LaPort plant, the process used by Novamont at that plant or the production figures resulting from that process. This opinion therefore does not address such issues.

[2] An understanding concerning the admissibility of exhibits at the time of trial dissolved in the period of post trial reflection. Novamont's motion to strike certain of SGK's exhibits is resolved as follows:

SGK exhibits — 139, 188 — granted.

SGK exhibits — 10, 61, 64, 66, 78, 80, 81, 111, 117, 118, 121, 123, 131, 142, 144, 178, 186 and 188 — denied.

research and educational institute. At MPI, Ziegler, together with Dr. Heinz Martin ("Dr. Martin") and others, studied catalytic reactions, several of which produced unexpected and significant results applicable to the production of plastics and synthetic rubbers. Ziegler patented certain of these processes. Included among them was the process which received the 115 patent, which was held by Ziegler until his death in 1973. Martin, the present manager of SGK, who testified on its behalf during the trial, also had an interest in the patents, including the 115.

SGK is the present licensor and titleholder of the 115 patent, which it holds in trust for counterclaim defendant MPI. SGK's principal function is and has been to license patent properties and collect royalties for MPI. SGK took title to the patent properties and all rights and obligations thereunder, including those embodied in license agreements, by trust agreement dated October 4, 1973, from the former counterclaim defendant, Maria Ziegler, the wife of Professor Ziegler.

Maria Ziegler, as sole heir and executrix of Ziegler's estate, took title to the patent properties by inheritance upon her husband's death. Both Ziegler and his wife, who died during the pendency of this action, were citizens and residents of West Germany. By memo endorsement dated July 15, 1980, the Court substituted Dr. Med. Marianne Witte, Dr. Erhart Ziegler, and Mr. Wilhelm Schmidtmann, all citizens and residents of West Germany, as defendants on the counterclaim for Maria Ziegler. Drs. Witte and Ziegler are the surviving children of the Zieglers, and sole heirs under a contract of inheritance left by Mrs. Ziegler. Mr. Schmidtmann is the duly appointed executor of Mrs. Ziegler's estate. None of the individual defendants appeared.

Pursuant to a series of agreements between Ziegler and MPI entered into December 22, 1955, Ziegler during his lifetime held

legal title to the licensed patent properties and license agreements in trust for and on behalf of MPI, which held all rights and obligations with respect thereto. Ziegler was required by these agreements to follow MPI's instructions with respect to licensing activities and to account and pass along in gross to MPI all royalties collected under the licenses. SGK, pursuant to agreement with MPI of December 22, 1955, was assigned the trust administration of the patent rights arising from Ziegler inventions, including the right to license the patent rights and to compensate the inventors, all at MPI's expense. SGK was at all times contractually required to follow MPI's instructions.

The '115 process patent employs catalysts in the production of propylene and co-polymers. The catalysts are "used to cause small molecules of gases or liquids to react together to form solid plastics and synthetic rubbers from which commercially used articles and objects may be fabricated for use in everyday living," *Ziegler* v. *Phillips Petroleum Company*, 483 F.2d 858, 861 (5th Cir.), *cert. denied*, 414 U.S. 1079, 94 S.Ct. 597, 38 L.Ed.2d 485 (1973). The '115 patent was issued on December 3, 1963 on an application filed on October 29, 1958 and expired on December 3, 1980. Montecatini-Edison S.A. ("Montecatini") participated in the research leading up to the patent, and after the patent was issued, Montecatini became Ziegler's agent with respect to licensing the patent in the United States. In the early days after Ziegler's discovery, many of those seeking to produce plastics visited Muelheim to learn about the process. In 1954, a license agreement was entered into between Ziegler and Hercules Powder Company ("Hercules") under which Hercules commenced the production of propylene. That agreement was amended in 1964. In 1967, a license agreement covering the use of the '115 patent was entered into between Ziegler and Novamont under which Novamont commenced production.

Other producers of propylene, however, refused to take licenses from Ziegler and became infringers in his eyes and in

the view of his licensees. Included in this group were Dart Drug Company, Eastman Kodak and Phillips Petroleum. Phillips Petroleum, produced propylene at its Monument plant, which it subsequently sold to Diamond Shamrock Chemical Company ("Diamond Shamrock") and, as part of the sale, undertook to hold Diamond Shamrock harmless against any infringement claims. By letter of May 23, 1969 Hercules formally notified Ziegler of infringements of his patent in accordance with their agreement.

Early in 1970 Ziegler's counsel sent letters to Diamond Shamrock, Phillips Petroleum, Eastman Kodak and Dart Drug seeking to obtain those companies as licensees. By July 9, 1970 Ziegler had entered into a patent license agreement and certain other agreements with Diamond Shamrock. These agreements will be considered in greater detail below, since aspects of them are claimed by Novamont to violate its preexisting MFL clause. Notwithstanding, by letter of September 23, 1970, Hercules gave notice to Ziegler of its suspension of royalty payments, since the infringements of which it had complained had not abated nor had the infringers been sued.

Ziegler thereafter commenced an infringement action against Phillips, which included a challenge to Phillips' unlicensed production of propylene. On June 23, 1971 the Honorable Sarah Hughes of the United States District Court for the Northern District of Texas declared the patent valid but not infringed by Phillips' use of the catalyst. Ziegler appealed the decision. Novamont, on July 9, 1971, notified Ziegler of its discontinuance of the payment of royalties; Ziegler protested the action. On March 24, 1972 he gave Novamont notice of termination of the 1967 agreement between them.

In the meantime, Ziegler sought to resolve his differences with Hercules, and negotiated with it to that end. These efforts were successful. On April 26, 1972, an agreement was entered into between Hercules and Ziegler. The details of that agreement

will be considered below, since it and its implementation in 1974, in addition to the Ziegler/Diamond Shamrock agreement discussed above, are claimed by Novamont to violate Novamont's 1967 MFL clause.

Despite correspondence and negotiation, further licensing under the '115 patent remained in limbo awaiting the determination by the Fifth Circuit of Ziegler's appeal from Judge Hughes' decision. This was announced on April 13, 1973. The Fifth Circuit restored Zigler's patent position against Phillips with respect to the use of the patent. Shortly thereafter, on May 65, 1974, Diamond Shamrock and Ziegler reached an agreement on the basis of their earlier 1970 understanding. During the same period, the discussions between Novamont and Ziegler intensified and on July 1, 1974 the agreement was entered into which is the basis of SGK's claim for unpaid royalties in this action.

Thereafter, Novamont obtained certain information concerning the Diamond Shamrock agreement and in August, 1977, announced its intention to adopt the provisions of the Diamond Shamrock license and to discontinue the payment of royalties, actions it claimed to be entitled to take by virtue of its MFL clause. This action by SGK to recover royalties followed. Novamont counterclaimed on the basis of its MFL clause. After discovery in this action, Novamont successfully moved to amend its counterclaim to include a claim arising out of the alleged violation of its MFL clause by the Hercules agreement. 485 F.Supp. 471.

It is against this background that further consideration must be given to the Ziegler/Diamond Shamrock Agreements, the Ziegler/Hercules Agreement and the Ziegler/Novamont Agreements.

The Ziegler/Diamond Shamrock Agreement

Diamond Shamrock had purchased the Monument Plant for making propylene from Phillips before Novamont and Ziegler entered into their 1967 agreement. Phillips operated the plant for Diamond Shamrock's benefit initially and also gave Diamond Shamrock a commitment to hold Diamond Shamrock harmless in the event of a determination at a later time that the process employed at the plant violated any patent rights.

After Hercules, an early Ziegler licensee, as set forth above, gave its notice of the infringement of other manufacturers in May, 1969, Ziegler's representatives, early in 1970, sought to enter into a license agreement with Diamond Shamrock. It was, of course, Ziegler's position that Diamond Shamrock was infringing his patent as was Phillips. Negotiations were held in mid-April and continued until July 9, 1970 when Diamond Shamrock and Ziegler reached an understanding which was set forth in three agreements.

The first agreement was a patent license agreement which granted Diamond Shamrock a non-exclusive license under Ziegler's '115 patent to make, use and sell propylene in the United States. Diamond Shamrock agreed to make a down payment of $200,000 to be credited at a 50% rate against future royalties. Royalty rates calculated on volume of sales were agreed upon. It was also agreed that Diamond Shamrock could accrue royalties and account to Ziegler for such accruals during the pendency of any patent litigation involving an alleged infringer bound to hold Diamond Shamrock harmless for infringement, the Phillips' action then being in progress. Dr. Martin, SGK's present Director, characterized this license agreement as the agreement which thereafter became the standard propylene agreement offered to licensees by Ziegler.

In addition, an option agreement was entered into permitting Diamond Shamrock to obtain a license covering certain co-polymers. Diamond Shamrock paid $20,000 for this option. It

was agreed that upon its exercise an additional $30,000 would be paid, both sums to be credited against future royalties. This option, though granted, was never exercised.

Finally, as an integral part of the agreement, Ziegler sent Diamond Shamrock the following undated letter:

Law Department

Diamond Shamrock Chemical Company
300 Union Commerce Building
Cleveland, Ohio 44115
U.S.A.

Gentlemen:

We have entered into a license agreement concerning the polypropylene field, effective July 1, 1970.

It is understood and agreed that this license agreement does not cover any alleged infringements of my patent rights by Diamond Shamrock prior to this July 1, 1970 date and that my rights to sue or take any other action against Diamond Shamrock or any other party in interest concerning this alleged past infringement are preserved.

I furthermore agree that, should there be any recovery by me, my successors, heirs or assigns for this past infringement by Diamond Shamrock as a result of suit, settlement, or otherwise, such recovery shall additively be credited to the down-payment made in accordance with Paragraph III of the license agreement in the same manner as if the same had initially constituted part of the down-payment actually made, and shall be credited against royalties as provided in the license.

Thereafter, Diamond Shamrock accounted and accrued royalties. After the final resolution of the Fifth Circuit decision in June of 1973 reversing the District Court and holding Phillips an

infringer of Ziegler's patent. Arnold Sprung ("Sprung"), counsel for Ziegler at the time and trial counsel for SGK in this proceeding, opened negotiations with Diamond Shamrock, concerning its accrued royalties and the pre July 1970 infringements.

March 27, 1974

Diamond Shamrock Chemical Company

Law Department
1100 Superior Avenue
Cleveland, Ohio 44114

Attention: John C. Tiernan, Esq.

Re: Ziegler Polypropylene License

Dear John:

This is to confirm our telephone conversation of today.

If Diamond Shamrock is agreeable to immediately render an accounting and make payment, we would consider the alleged breach of the Polypropylene License of July 1, 1970, rectified.

I have telexed Studiengesellschaft Kohle mbH to forward Diamond Shamrock the statement required by Article VI of the agreement, and agree hereby to hold your royalty payment check in escrow, pending your receipt of the written statement, as set forth in Article VI.

I also confirm that I am willing to enter into negotiations concerning Diamond Shamrock's polypropylene production going back prior to July 1, 1970, and suggest that we get together for this purpose, should you desire.

Best personal regards,
Very truly yours,
BURGESS, DINKLAGE & SPRUNG

By May 6, 1974, these negotiations were concluded by an agreement between Ziegler and Diamond Shamrock which provided that an additional $750,000 would be paid by Diamond Shamrock and

> "additively credited to the down-payment made in accordance with Paragraph III of the license agreement of July 1, 1970, in the same manner as if the same had initially constituted part of the down-payment made, and shall be credited against royalties as provided in the license, i.e., no more than fifty percent (50%) of any payment otherwise due pursuant to Paragraph IV of the license for any one year shall be credited against the total down-payment".

Diamond was released thereby from any liability for pre July 1, 1970 infringement.

In terms of its continuing running royalty, aside from the effect of the down payment, the Diamond Shamrock rates were slightly more favorable than those held by Novamont in 1970, although certain third party payments as offsets were not included and other differences existed between the agreements. For reasons not made clear on this record, when given terms of the Ziegler/Diamond Shamrock agreement in the fall of 1970, Novamont chose not to adopt its terms.

The Ziegler/Hercules Agreements

Hercules was one of the early participants in the work of Dr. Ziegler and entered into a Polyolefin Contract with him on September 24, 1954, which was amended in 1962 and supplemented in 1964 in ways not material to this dispute. By the late 60's Eastman Kodak, Dart Drug and Phillips, who declined to enter into license arrangements with Ziegler, were producing polypropylene also. As noted above, in May, 1969, Hercules gave notice of this infringement under its agreement with Ziegler, and a period of negotiations ensued.

Hercules twice extended the period during which Ziegler could abate the infringement or file suit against the infringer and then, on September 23, 1970, gave notice that it would suspend payment of royalties after April, 1970. Sprung believed this to be a negotiating position looking toward a reduction of royalties. To resolve the matter he proposed that the 115 patent be deemed to expire 3 years before its actual termination date for purposes of calculating Hercules' royalty obligations, and that Hercules agree that Ziegler need sue only one infringer at a time. Hercules apparently kept this proposal in mind, but its interest in an immediate resolution of this dispute over the terms of the license agreement was undoubtedly affected by the lower court decision in the *Phillips* action in mid-1971. The situation was reported by Hercules to Ziegler on July 12, 1971 as being "far more complicated than I [the Hercules Assistant General Manager, Polymers Department] realized." In an exercise of personal diplomacy, Von Kriesler, one of Ziegler's close associates, wrote Brown, President of Hercules, calling upon personal and past business ties to bind up the dispute. In November, 1971, Brown responded, refusing to pay royalties but seeking to keep the discussions alive.

Thereafter the negotiations moved forward in a deliberate and calcualted fashion. Hercules estimated its exposure and Dr. Martin and Sprung evaluated the Ziegler position, recognizing that Ziegler's leverage depended in large measure on the successful resolution of the appeal in the *Phillips* action. On February 1, 1972 Hercules proposed a $1,250,000 non-refundable down-payment, a fully paid-up license up to a capacity of 600 million pounds a year and a royalty of 1% of net sales in excess of that quantity.

Sprung, having received this Hercules proposal, forwarded it to Muelheim together with the computer run upon which the $1,250,000 down payment was determined. This calculation included a royalty rate of .73% of the projected capacity to

produce polypropylene and a projection of the future price of polypropylene based on past price movements, a projection which showed a decrease of the price over the next six years. The royalty rate was the minimum rate agreed upon in the 1964 supplement to the original Ziegler/Hercules agreement. The calculation implicitly accepted the earlier suggestion of Ziegler with respect to a three year advance in the termination date, for the calculation ran only through 1977. A present value of money factor of 12% was applied. The cumulative present value of the royalties came out to $1.656 million dollars, which Hercules then reduced to $1.2 million as a settlement figure. Sprung proposed to Ziegler a reply to Hercules to the effect that either a 25% settlement reduction from $1.6 million to $1.25 million or the three year earlier termination would be satisfactory, but not both. Sprung pressed for consideration of the proposal noting: "This may be last opportunity to obtain substantial royalty payments prior to decision on appeal in Phillips' suit."

On February 21, 1972 Dr. Martin, on Ziegler's behalf, sent Sprung a computer run including 1970 and 1971. The results of the run varied from the Hercules price calculation as a result of the period covered. Hercules had started its projection in 1968 and Ziegler noted that a 1967 starting date would produce a significantly higher price and consequently an increased dollar value for sales in the future projections. The effect of a constant price calculation was considered, and Dr. Martin concluded that under Ziegler's calculations averaging its two methods of calculating price and continuing through 1980, a 75% settlement would require a $1.7 million dollar down-payment.

On March 16, 1972 Sprung and Dr. Martin met with Hercules, and an agreement was arrived at. This agreement was formalized by letter from Hercules on April 26, 1972, and accepted by Ziegler. It amended the prior 1954, 1962 and 1964 agreements and provided as follows:

1. In settlement of any and all liabilities for royalties accruing under the Polyolefin Contract for the period April 1, 1970 through December 31, 1972, Hercules will pay Ziegler $770,000.00 promptly after your acceptance of this letter.

2. As consideration for immunity from suit after December 31, 1972, as granted in paragraph 5 hereof, Hercules will pay Ziegler $30,000.00 promptly after your acceptance of this letter. In addition, when and if Ziegler receives a favorable decision on the validity of U.S. Patent 3,113,115 (without regard to the decision on infringement of said patent) from the Court of Appeals in the pending *Ziegler v. Phillips* Civil Action in Texas, Hercules will promptly pay Ziegler $800,000.00 plus interest from May 1, 1972 at 6%.

3. All payments to Ziegler under paragraphs 1 and 2 shall be non-refundable to Hercules by Ziegler.

4. In the event U.S. Patent 3,113,115 is held invalid by the Court of Appeals in the above-mentioned Civil Action, Hercules will be excused from the $800,000.00 payment referred to in paragraph 2 hereof but in such event the immunity from suit granted in paragraph 5 hereof shall not apply to any process patent that Ziegler may hereafter obtain corresponding substantially in scope to U.S. Patent 3,113,115 unless Hercules shall within a reasonable time after issuance of such patent make said $800,000.00 payment.

5. Ziegler hereby grants Hercules a fully paid-up immunity from suit until December 3, 1980 under Professor Ziegler's U.S. Patent rights with respect to polypropylene (including non-elastromeric copolymers with a minor amount of ethylene) up to a limit of six hundred million pounds (600,000,000) per year sales. On any sale quantity of polypropylene over six hundred million pounds

(600,000,000) per year. Hercules will pay royalties of one percent (1%) of Net Sales Price.

Dr. Martin testified that the schedule of payments was determined by Hercules' tax considerations and that he considered the settlement to constitute a payment of $1.6 million dollars in settlement of all past infringement and in payment for the "fair value" of the paid-up license.

Q What was your belief that the $1.6 million figure we had negotiated represented?

A It was my true belief that this was the fair value of the residual time up to '80 of the Hercules agreement.

* * * * *

Q I notice in [the agreement] it does not simply say they're going to make two payments of $800,000 each. They have a sum in paragraph 1 of 770 and in 2 of 30,000 and so forth.

Q What was your understanding of those segregations of those sums?

A The sum is right. It comes out to 1.6. Hercules had some desire to divide up because of tax purposes the first 800,000.

Q For their own convenience?

A Yes.

A handwritten exhibit was introduced of notes which Dr. Martin testified were made by Sprung during the meeting and exchanged with him. These notes confirm the testimony of Dr. Martin as to the Ziegler view of the agreement. The notes contain figures which were said to represent the initial positions of the parties and the rejection of those positions. Then there follows a calculation which Martin explains as follows:

CONTINUED DIRECT EXAMINATION BY MR. SPRUNG:

Q When we adjourned you were discussing the Hercules meeting.

I now hand you an exhibit which has been marked as Plaintiffs' Exhibit 104. I ask you if you can identify the scribbling?

A Yes.

Q Tell us what that is?

A This was the written correspondence between us two during the meeting with Hercules.

Q Could you explain what those various figures are and what the significance of them are?

A I can try. In the first left, upper left corner, we started with the figure Hercules had offered us and below this figure the new figure we computerized. Then we crossed this out.

Q Which figure is that?

A The 2.318.

Martin's testimony continues with the detailed description of the calculations made. It indicates that however Hercules reached its calculation of the $1.6 million down payment, Ziegler considered it on the basis of a royalty extending through the life of the patent, using a projected price and consequent sales volume established on a historical basis. According to Dr. Martin, this amount was reduced by a present value calculation, and then further reduced by an amount calculated to offset the increased royalty rate contained in the agreement on the excess of the paid-up production over 600 million pounds, in order to keep the rates consistent with the previous Hercules rate. This amount was then further reduced by an arbitrary 20%, urged upon

Ziegler by Hercules, which represented a reduction of the estimated volume figures which had been the result of a computer calculation of production capacity based on a time projection. That reduction was said to be required by experience which established that unforeseen delays as a consequence of construction lags, labor disputes and other factors could well cause deviations from the computer projections.

There is substantial evidence, including the memorandum submitted to Hercules' executive committee on April 7, 1972 which sought approval of the agreement, that Hercules never changed its method of calculating the $1.6 million figure, and continued to view that figure as reflecting a forgiveness of royalties for three years at the end of the patent period. Another difference between the methods of calculation of Hercules and Ziegler was the treatment of the royalties accrued during the period of Hercules non-payment, the question being whether they were forgiven, discounted or included in the total down payment.

Regardless of the different calculations said to have been used to reach the $1.6 million figure, there is no dispute as to that figure and the terms of the license agreement. The letter agreement spoke simply of the payment of $770,000 in settlement of all past royalties due for the period of suspension, $30,000 in consideration for entering into the relationship and $800,000 to be paid upon a favorable decision in the *Phillips* action. For these payments Hercules received a license over the life of the patent and was required to pay royalties equivalent to 1% of all net sales over 600 million pounds annually.

The Ziegler/Novamont Agreements

In 1964, a license agreement was entered into between Ziegler and Novamont. On December 21, 1967 this agreement was terminated and was superseded by an agreement entitled "Propylene Ziegler Patent License Agreement." Montecatini,

the then parent of Novamont, signed the agreement on behalf of Ziegler as his licensing agent.

The agreement licensing the use of the 115 patent by Novamont contained 19 articles and consisted of 19 pages. For the purpose of this action only Article IX need be set forth in its entirety. It follows:

ARTICLE IX — Most Favored Licensee Clause

A. 1) Should Licensor, during the life of this Agreement, grant to any company producing Agreement Polymers in the United States a license under United States patent 3,113,115 which license contains royalty provisions that, when considered in their entirety, are more favorable than those specified in Article III hereof, then and in that event Licensor shall promptly furnish Licensee with a full text of the royalty provisions of such license.

2) Licensee shall be entitled, upon written request within ninety (90) days after receipt of the aforesaid full text of such other license from Licensor, to substitute for the entirety of this Agreement all of the provisions of such other license.

3) The substituted license shall be effective and this Agreement suspended as of the date of the request for substitution of terms by the Licensee.

4) If the substituted license ceases to be in force during the time period in which this Agreement would have been effective but for such substitution, then and in that event the suspension of this Agreement shall be terminated and this Agreement shall again be binding upon the parties for the balance of its term.

D. In no case shall any provision of this Article IX be construed to impose any obligation on Licensor to repay to Licensee any royalties previously paid pursuant to this

Agreement or any antecedent license agreement under United States patent 3,113,115.

Novamont paid royalties under this agreement during the period from 1967 until mid-1971, although Novamont sought unsuccessfully to modify the agreement in the light of the competitive situation in the United States including the infringing activities of others.[3] It was also during this period that Hercules gave its notice of infringement to Ziegler and that Diamond Shamrock and Ziegler entered into their agreements of July 9, 1970 already discussed. Indeed the Diamond Shamrock agreement was discussed by Ziegler and Novamont during this period.[4]

From the documents submitted, the correspondence, and the testimony of Dr. Martin, it appears that despite efforts at secrecy, most information concerning license agreements soon found itself shared in the industry. By letter of September 24, 1970 Novamont sought to enlist Montecatini's help in obtaining relief from royalties due Ziegler in view of the widespread infringement. Within two weeks, Smareglia of Novamont sought to obtain from Montecatini information about the Diamond Shamrock agreement which had been reached on July 9, 1970. On October 14, 1970, Manzillo, President of Novamont, confronted the Ziegler representatives with the "rumors" and requested the Diamond Shamrock agreement under Novamont's MFL clause.

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[3] Both parties were ably represented, not only during the trial but during these negotiations, which have been the subject of extensive discovery in this action under the able direction of Magistrate Leonard Bernikow, and in other litigation as well. For example, a virtually verbatim 49 page record of the meeting between the parties in Muelheim on March 2 and 3, 1971 is available for the court's enlightenment.

[4] It should be noted that the "divorce" between Novamont and Montecatini had been achieved and Novamont no longer had any relationship to Ziegler's former licensing agent.

By letter of October 30, 1970 Sprung forwarded the Diamond Shamrock agreement along with a letter from Diamond Shamrock of September 4, 1970 confirming that the agreement did not cover past infringement. The Diamond Shamrock letter duplicated the Ziegler undated letter relating to infringement, quoted above, entered into at the time the agreement was signed. However, the Diamond Shamrock letter omitted the third paragraph of Ziegler's letter which, as indicated above, stated as follows:

> I furthermore agree that, should there by any recovery by me, my successors, heirs or assigns for this past infringement by Diamond Shamrock as a result of suit, settlement, or otherwise, such recovery shall additively be credited to the down-payment made in accordance with Paragraph III of the license agreement in the same manner as if the same had initially constituted part of the down-payment actually made, and shall be credited against royalties as provided in the license.

Neither this paragraph nor the option agreement relating to copolymers was every shown to Novamont. The terms of those documents are claimed by Novamont to be more favorable to the licensee than the terms of Novamont's agreement were to Novamont; their concealment is therefore claimed to violate its MFL.[5]

Ziegler's representative did offer the revealed terms of the Diamond Shamrock agreement to Novamont, without requiring

[5] In this connection it is noted that the option was never exercised. *See* pp. 560-561, *supra*. As to the third paragraph, as noted above, after the *Phillips* action was decided in favor of Ziegler in 1973 and all further appellate proceedings subdued, Diamond Shamrock and Ziegler entered into the agreement of May 6, 1974 which provided for an additional payment of $750,000 to be "additively credited" to the down-payment already made and to constitute a credit against 50% of future royalties annually until exhausted. This agreement gave effect to the third paragraph of Ziegler's July, 1970 letter and is claimed by Novamont to complete the breach of its MFL clause.

a $200,000 down payment, but also without giving credit for prior royalties paid. At a meeting on November 6, 1970, Ziegler's representatives refused to grant Novamont the right to accrue, rather than pay, the royalties due during the period of the *Phillips* litigation. Although Novamont was offered the literal terms of the Diamond Shamrock provision pertaining to accrual, those terms applied specifically to Diamond Shamrock in its position as the beneficiary of the hold-harmless agreement with Phillips, and would have bestowed no right to accrue during the pendency of the Phillips' suit on Novamont. The Diamond Shamrock accrual provision, in pertinent part, reads as follows: "Licensee may hold and accrue royalties without forwarding the same to Ziegler during any period during which Ziegler is engaged in a suit for patent infringement involving the process utilized by Licensee and being defended by a party under a contractual obligation, to hold Licensee harmless." Novamont, based on the information it had received, made no effort to obtain the Diamond Shamrock terms.

Still seeking relief from its license agreement and the competitive situation in the U.S. market, Novamont gave notice on July 9, 1971 of its discontinuance of royalty payments in the wake of the *Phillips* lower court decision. Sprung turned his attention to Hercules and concentrated his efforts on resolving the Ziegler/Hercules dispute. As set forth above, by March 17, 1972 an agreement seemed close at hand, and was in fact reached on April 26, 1972. In the meantime, on March 24, 1972 Sprung sent Novamont a notice of cancellation of its 1967 license arising out of its termination of royalties in July of the prior year.

By May, 1972 Novamont had gotten wind of the Hercules agreement and claimed a right to enforce its MFL clause. It chose to disregard Ziegler's claim that it was an infringer. Sprung informed Novamont that Hercules had a paid up license and by June 26, 1972 offered to calculate a paid up license on

the same basis, namely, $1.6 million for a capacity of 600 million pounds a year. By letter of July 19, 1972 Sprung stated:

> The royalty rate on which the computer calculations were made was the royalty rate in Hercules' existing agreement with Professor Ziegler of which I believe you are cognizant. The prepaid discount was at 12%. Quite simply, Hercules agreed to pay a royalty of $1,600,000, immediately paying $800,000 and agreeing to pay a further $800,000, plus 6% interest, upon the decision of the 5th Circuit Appeals Court provided that they did not reverse the District Court and hold the '115 patent invalid. There were no other contingencies provided.

Pressed further by Novamont, Sprung wrote the following on August 28, 1972:

> Apparently, I have not been too clear in my proposals to you. Hercules' royalty rate has nothing to do with the arrangement that Professor Ziegler is willing to offer to Novamont in order to enable Novamont to obtain a paid-up license. A paid-up license would only be made available by taking Novamont's present agreement and on the basis of a computer run, taking into consideration a diminishing price for polypropylene, to project the royalties which would be due from Novamont over the life of the patent up to the maximum plant capacity provided for, and to calculate on this basis, taking into consideration a 12% discount, a paid-up value.

Sprung thereby did not reveal the .73% royalty rate previously obtained by Hercules on which the calculation was based, nor did he reveal what Dr. Martin in a June 21, 1972 telex to Sprung on the subject referred to as the "further admitted discount to Hercules." Although this discount could refer to the alleged three-year free ride, the preponderance of the evidence indicates that it refers to the 20% contingency discount intended to account for risks in achieving the anticipated increased capacity,

a discount not mentioned to Novamont in Sprung's August 28, 1972 letter.

The evidence indicates three possible sources of this 20% discount: the forgiveness of the accrued royalties for 1971 and 1972; the alleged three-year free ride from 1977-1980; and the 20% contingency to allow for construction delays and other unexpected obstacles to the achievement of the projected, unusual capacities. While, as indicated, the evidence preponderates that the contingency factor was the element used in Ziegler's calculations, in any case, none of three possible sources was described to Novamont in Sprung's August 28, 1972 letter.

There the matter lay until the decision of the 5th Circuit in April, 1973. One month after that decision, Manzillo filled in the blanks, as had been suggested by Sprung in his offer of August of 1972 and expressed interest in negotiating. Sprung replied, offering to settle the infringement claim for $650,000 and offering a paid-up license for 120 million pounds of capacity for 1.2 million dollars. In authorizing this proposal, Dr. Martin used nearly the same methodology as had been employed in the Hercules computation. However, there were several significant differences, two of them tied to conditions in the polypropylene and money markets and one reflecting differences between the underlying Hercules and Novamont license agreements. The Hercules lump-sum had been calculated at a time when polypropylene prices were decreasing, and the calculations had taken that trend into account. However, Ziegler's offer to Novamont was based on a computed price calculation that was flat throughout the seven year period. Although, according to Ziegler, polypropylene projected prices then showed an increase which would have resulted in increased royalties a constant price was chosen for use in the Novamont calculations in an effort to avoid discriminating against Novamont and in favor of Hercules in view of the changing pattern of propylene pricing. Another difference between the basis of the two lump-sum offers was that

the Novamont figure was arrived at through application of a 10% present value factor, rather than a 12% factor. That change reflected changes in the price of money in the marketplace. Finally, the royalty rate used was Novamont's prior royalty rate, approximately 1.5% as opposed to Hercules. 73%. In other regards, leaving aside the issue of the suspended payments by Hercules, the calculations followed the Ziegler view of the Hercules formula, including a 20% discount for unexpected production delays. Although not a precise duplication of the Hercules calculation, it constituted a rough approximation. Novamont was not informed of the three year grace period proposal.

Despite meetings in November, 1973 and March, 1974, the parties were unable to reach agreement. Finally, with the *Phillips* action resolved and the Hercules down-payments in hand, Ziegler rejected Novamont's proposals. On July 1, 1974 Novamont and Ziegler reached an agreement on the terms demanded by Ziegler.

The relevant terms were as follows:

> WHEREAS, NOVAMONT and Professor Dr. Karl Ziegler (hereinafter called "ZIEGLER") had entered into an agreement on December 21, 1967, entitled "Polypropylene Ziegler Patent License Agreement"; and
>
> WHEREAS, a disagreement had arisen concerning NOVAMONT'S obligations under said agreement, and ZIEGLER had forwarded a Notice cancelling the agreement, which NOVAMONT had maintained was ineffective; and
>
> WHEREAS, STUDIEN is the successor to the Patent Rights of ZIEGLER and to the rights of ZIEGLER under said agreement of December 21, 1967;
>
> NOW, THEREFORE, in order to settle the differences between the parties, the parties agree as follows:

1. The parties agree that the Notice of termination of the agreement between NOVAMONT and ZIEGLER, dated December 21, 1967, is ineffective and the agreement dated December 21, 1967, remains in full force and effect and is uncancelled.

2. NOVAMONT shall immediately render an up-to-date accounting to STUDIEN for all royalties past due under the agreement of December 21, 1967, including an accounting for the period extending from the first quarter of 1971 to date, and shall immediately make payment of said past due royalties to STUDIEN, plus interest calculated at a rate of ten percent (10%) per annum.

3. As of the Date of this Agreement, the agreement of December 21, 1967, shall be converted to, and replaced by the License Agreement attached hereto as Appendix A.

In effect, Novamont was required to pay past royalties and to sign the so-called standard polypropylene license at its previously established rate.

The Issues

Under the facts as found above certain issues remain for resolution.

1. Is Novamont entitled to MFL treatment with respect to licenses entered into from July 1971 to July 1, 1974, its period of infringement?

2. Does the Ziegler/Diamond Shamrock option agreement violate the Novamont MFL clause?

3. Does the undisclosed Ziegler/Diamond Shamrock agreement to treat any infringement payment as an additive downpayment violate the Novamont MFL clause?

4. Is Novamont entitled to any benefits which might have resulted from an accrual of royalties during the period of the Phillips action?

5. Does the Ziegler/Hercules agreement violate the Novamont MFL clause?

6. Was Novamont defrauded by SGK's failure to disclose to it the terms of the Ziegler/Hercules agreement?

7. Was Novamont defrauded by SGK's representation that the Hercules agreement contemplated the application of the entire $1.6 million payment toward future royalties rather than the application of nearly half of that sum toward past due royalties that had been suspended?

The Conclusions

The Effect of the 1974 Ziegler/Novamont Agreement

[1] The Ziegler/Novamont agreement of July 1, 1974 was entered into by powerful parties, ably represented. At issue is whether the agreement means what it says and restores Novamont to its 1967 position or whether Novamont is barred as an infringer from enforcing its MFL clause with respect to events occurring during the period of its infringement, which of course is the very period during which the Diamond Shamrock and Hercules agreements were entered into. I conclude the agreement means what it says and that Novamont is entitled to enforce its MFL clause with respect to events occurring during its period of infringement.

The very issue between the parties was the infringing conduct by Novamont, conduct that resulted from Novamont's own determination to take a chance on the invalidity or inapplicability of the patent after the lower court decision in *Phillips*. When the uncertainty created by that decision was removed by the 5th Circuit decision in 1973, Novamont was in an exposed position and ultimately paid up, dollar for dollar, the royalties

that were due during its infringing period. It bargained for, paid for and got the restoration of its prior status.

Given the demonstrated skill of Novamont's counsel, it may well be that even at the time of the 1974 Ziegler/Novamont agreement, suspicions may have been harbored that there was more to the Diamond Shamrock and Hercules agreements than met the eye — a suspicion which turned out to be true, whatever the legal effect of that fact may be. Sprung, Ziegler's United States negotiator, certainly highly experienced and in command of the facts, knew as a participant all the facts relevant to the Diamond and Hercules agreements. Nonetheless, there is no evidence in this carefully presented and well documented record that the retroactivity provision of the Ziegler/Novamont agreement was intended to be anything other than what it purported to be. The clear language controls and Novamont is entitled to the benefits of its 1967 MFL clause, if any.

The Ziegler/Diamond Shamrock Option Agreement

[2] The Diamond Shamrock option agreement for copolymers was concealed from Novamont. That concealment, however, did not violate Novamont's MFL clause, which required revelation only of actual license agreements containing royalty provisions that, in their entirety, were more favorable than those contained in the Novamont license agreement. The Diamond Shamrock option agreement was not such a license agreement. It was not a license agreement at all, but an option to create a license agreement. *See generally Plantation Key Developers, Inc. v. Colonial Mortgage Co.*, 589 F.2d 164 (5th Cir. 1979) (proferred contract underlying option agreement not binding contract until accepted); *1020 Park Ave., Inc. v. Raynor*, 97 Misc.2d 288 411 N.Y.S.2d 172 (Civ.Ct.N.Y.Cnty. 1978) (exercise of option converts offer into binding contract). As such, it did not fall within the purview of the MFL clause, and its disclosure was not required by that clause. Furthermore, because it was never exercised, it did not lead to the creation of a

license agreement the disclosure of which might have been required.

Even if the option agreement is viewed not as a separate contract but as one component of Diamond Shamrock's license agreement, the conclusion stands that its disclosure was not mandated by the MFL clause. That is because the option agreement was not a *royalty* provision, and only royalty provisions were covered by the MFL clause. Therefore, even though the option agreement may well have been beneficial to Diamond Shamrock, it was not the type of provision which the MFL clause required the licensor to disclose.

Finally, since under its 1967 agreement Novamont had the right to produce co-polymers, the Diamond Shamrock option agreement was not more favorable than the agreement Novamont already had. For that reason, too, its concealment was not violative of Novamont's MFL clause.

The Ziegler/Diamond Shamrock Additive Down Payment Agreement

[3] There is no doubt that Ziegler concealed from Novamont the additive credit features of his 1970 contingent agreement and final 1974 settlement agreement with Diamond Shamrock. Those provisions were conveniently and deliberately withheld from Novamont, a withholding which SGK claims was justified by the line of cases holding that MFL provisions similar to those in the instant case do not apply to the settlement of infringement claims. *See Searle Analytic, Inc. v. Ohio-Nuclear, Inc.*, 398 F.Supp. 229 (N.D.Ill. 1975); *Universal Oil Products Co. v. Vickers Petroleum Co.*, 41 Del. 238, 19 A.2d 727 (1941); *Raytheon Mfg. Co. v. Radio Corporation of America*, 286 Mass. 84, 190 N.E. 1 (1934). The policy behind such holdings appears to be to facilitate settlements by not compelling licensors to choose between 1) exacting from infringers royalty payments for the period of infringement equivalent to those paid during the same period by those holding licenses containing

MFL clauses and 2) forfeiting the payments made during that period by those licensees. The wisdom of that policy is amply demonstrated by the facts here, which involve an important patent, of long and hotly contested validity, and multiple parties with competing interests, variously situated with respect to the patent throughout the period of conflict. During the pendency of the infringement action involving *Phillips*, Ziegler sought to achieve settlements in order to shore up his patent position, to minimize infringement, and to obtain down payments, presumably to assist in the necessary litigation. In these circumstances, it must be assumed that a commitment and cash on hand in 1970 and 1972 during the period of patent litigation were more valuable to Ziegler than the same commitments and cash would have been after the validation of his position by the Fifth Circuit in 1973. At the same time, the competing manufacturers of polypropylene were forced to make judgments with respect to their positions vis-a-vis the patent and its holder: whether to infringe or settle, whether to make or withhold royalty payments, and so on. In such circumstances, the policy that withholds MFL treatment from arrangements regarding past infringement serves the valuable purpose of resolving conflict and encouraging settlement.

The difficult aspect of the 1974 Diamond Shamrock settlement for past infringement is that the device used takes the form of a conversion of liability for any past infringement into a down-payment credited towards future royalties. In that sense, the settlement not only looked to the past but also affected the future, a confusion made evident by this court's earlier rulings on the defendants' motion for summary judgment. *See Studiengesellschaft Kohle mbH v. Novamont Corporation*, 77 Civ. 4722 (RWS) (S.D.N.Y. Oct. 19, 1978). However, that fact alone does not suffice to trigger a departure from the rule established by precedent for the treatment of past infringements. Because the secret agreement between Diamond Shamrock and

Ziegler related to the method by which a past infringement was to be resolved, and because the royalty terms themselves, as opposed to the method of payment, were made available to Novamont, the settlement agreement was not subject to nor violative of Novamont's MFL clause.

The important point here is that insofar as the arrangement looked to the past, it was not covered by the MFL clause, *see Universal Oil Products, supra; Raytheon Mfg. Co., supra,* and insofar as it pertained to the future in its provision for down-payments on future royalties, Novamont was offered a similar agreement, which it did not accept. Because the MFL clause was prospective only, that offer satisfied the MFL clause obligations of SGK. *See Universal Oil, supra; Raytheon, supra.*

In this regard, there would appear to be no reason to distinguish between the original down-payment agreement Ziegler reached with Diamond Shamrock in 1970 and the subsequent additive credit agreement which resolved the dispute about Diamond Shamrock's past infringement. Novamont was offered an agreement with the same royalty terms utilized in both of those Diamond Shamrock agreements, and it is equivalence of royalty terms that the MFL clause provides for.[6] The fact that one portion of those royalty payments was paid as part of a settlement of past infringement does not alter the essential fact: the nature of the royalty terms themselves.

In addition, Diamond Shamrock's application of payments covering past infringement toward future royalties did not entitle Novamont to receive credit toward future royalties for its own payments made during the period of Diamond Shamrock's

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[6] The reference to "royalty terms" here means the rate at which royalties were to be assessed for future manufacture under the patent. In fact, the creditable down-payment made by Diamond Shamrock in 1974 was twice as large as a payment calculated through application of those royalty terms to the manufacture during the infringement period would have been.

infringement. That conclusion follows from the rulings in *Searle Analytic, Inc., supra,* and *Universal Oil Products Co., supra.* In *Searle Analytic,* the licensee, "Ohio," was protected by an MFL clause in all relevant respects indistinguishable from that present here. A subsequent agreement entered into between the licensor and another party forgave that party's past infringement. Ohio claimed that it was entitled to an abatement of the royalties it paid during the period of the subsequent licensee's forgiven infringement. The court ruled against Ohio, finding that the licensor had not forfeited its right to Ohio's royalty payments during the period of the third party's infringement by forgiving that infringement. A similar conclusion was reached in *Universal. See also, Rothstein v. Atlanta Paper Co.,* 321 F.2d 90 (5th Cir. 1963) (discussing "built-in-gap" between prior and subsequent licensees"); *Raytheon Mfg. Co., supra.* As these cases indicate, Novamont was not entitled to a credit toward future royalties for the payments it made during the period of Diamond Shamrock's infringement, just as Ohio was not entitled to an abatement in *Searle Analytic.*

Finally, there is no evidence before me that a prepayment of future running royalties was a benefit to the licensee; given the cost of money during this period, a demonstration to that effect would be extremely difficult, if not impossible, and none was attempted here.

[4] Another feature of the Diamond Shamrock agreement is claimed to violate Novamont's MFL clause, namely, the right granted Diamond Shamrock to accrue, rather than pay over, royalties during the period of the *Phillips* litigation. I agree that the failure to offer a comparable accrual right to Novamont constituted a violation of its MFL clause. SGK argues that it satisfied its MFL obligation by offering Novamont the literal terms of the Diamond Shamrock accrual provision. However, the proof at trial established that those terms were tailored to Diamond Shamrock's situation vis-a-vis Phillips and that they

would not, if included in an SGK-Novamont agreement, have allowed Novamont to accrue royalties during the *Phillips* litigation. To accept SGK's argument that by offering these terms to Novamont, to whom they were useless, SGK satisfied its MFL obligations would be to ratify a procedure with the potential of vitiating MFL clauses altogether. If a licensor were able to evade bestowing more favorable royalty provisions contained in subsequent license agreements on prior licensees protected by MFL clauses through the simple expedient of designing royalty provisions that benefit only the subsequent licensee, then the licensor would possess the ability to sap MFL clauses of their substance and utility. I do not accept SGK's argument because it would lead to precisely that result. Novamont was entitled by virtue of its MFL clause and SGK's agreement with Diamond Shamrock to an agreement that allowed it to accrue royalties during the pending of the *Phillips* litigation, just as Diamond Shamrock was allowed to do. It was not offered such an agreement. It is therefore entitled to succeed on the portion of its counterclaim based on deprivation of the accrual right to the extent that it was harmed thereby.

The appropriate measure of damages on Novamont's counterclaim for this breach of the MFL clause is the $94,651 interest Novamont was required to pay on the royalties owed for the period of the *Phillips* litigation but withheld during that litigation. That is the measure because Diamond Shamrock was charged no interest on the royalties it accrued during that period.

The Ziegler Hercules Agreement

The Ziegler/Hercules agreement was reached in the spring of 1972, as described above. Although SGK has consistently referred to the agreement as simply the conversion of existing running royalty obligations into a down-payment of $1.6 million, thereby seeking to invoke *Hazeltine Corporation v. Zenith Radio Corporation*, 100 F.2d 10 (7th Cir. 1938), *cert. denied*,

306 U.S. 656, 59 S.Ct. 646, 83 L.Ed. 1054 (1939), the agreement on its face does not so provide. As finally approved, the agreement divided the amounts to be paid into 770,000 for past infringement $30,000 for entering into the agreement, and $800,000 as a down-payment in lieu of running royalties to be paid during the life of the '115 patent for production of polypropylene up to a capacity of 600 million pounds, with an additional royalty of 1% to be paid on sales in excess of 600 million pounds. As set forth above, this division of the amounts to be paid was arbitrary, made at Hercules' request and solely for its own tax purposes. I conclude that this division of the down-payment was not only arbitrary but artificial and did not represent the actual agreement of the parties. The actual agreement called for a full $1.6 million down-payment in the event that Ziegler was successful in the *Phillips* action, which down-payment was entirely directed toward future production, rather than partially directed toward past infringement. That finding does not lay this issue to rest, however, for the effect of the Novamont MFL clause in the light of the Hercules lump-sum payment agreement remains to be determined.

SGK rests in large measure on *Hazeltine, supra.* in *Hazeltine,* the Hazeltine Corporation ("Hazeltine") was the holder of patents covering certain radio applications. It entered into license agreements with various manufacturers of radios, including Zenith. Zenith's license agreement contained a "most favored licensee" clause, providing that Zenith was entitled to a royalty rate as low as that paid by any other licensee. The contract provided that royalties would be calculated at a given percentage of selling price. In lieu of paying such percentage royalties, Hazeltine licensees, including Zenith, could elect, at the beginning of any given year, to pay a lump sum of $150,000. Zenith argued that if any other licensee elected to pay such a lump sum in lieu of a percentage of sales, and at the end of the year it appeared that the licensee's royalty was lower than it

would have been had it been calculated according to the percentage rate specified in Zenith's own license contract, then Zenith would be entitled to utilize the lower percentage rate allegedly reflected in the other licensee's lump-sum payment. The court rejected this argument, holding that Zenith had no right under its contract to convert the rate actually achieved by a licensee electing a lump-sum formula into a percentage rate applicable to Zenith's contract. The court found that a lump-sum payment represented an altogether different method of calculating royalties than that used in fixing a running royalty schedule and that an MFL clause does not entitle its holder to the security of the latter coupled with the potential benefits of the former. Hence, the court refused to allow Zenith to avoid the risks inherent in a lump-sum payment, yet enjoy its advantages should it turn out that Zenith would have fared better by choosing a lump-sum form of payment at the beginning of the year. The court concluded that the MFL clause was satisfied so long as the same lump-sum figure was offered to Zenith. That offer had been made, and so the court concluded there was no MFL violation.

The essence of *Hazeltine* is that an MFL clause does not entitle its holder to a lump-sum down-payment option calculated using the same royalty rates as those effectively reflected in a lump sum accepted from a competitor. Applied to this case, its teaching would be that SGK satisfied its MFL obligation by disclosing the terms of the Hercules agreement, thereby allowing Novamont to opt for a $1.6 million down-payment for 600 million pounds of annual production. Under *Hazeltine*, SGK went beyond the call of its MFL duty by offering Novamont a lump-sum payment option calculated according to the method employed by Ziegler in the Hercules negotiations, with royalty rates derived from the Novamont agreement.

[5] If *Hazeltine* were the law of this Circuit, it would dictate victory for SGK on this portion of this lawsuit. However, the

vitality of *Hazeltine* is questionable, for, though cited in several treatises, *see, e.g.*, A. Deller, 4 *Deller's Walker on Patents*, 691 (2d ed. 1965), its holding has not been relied upon in this or any other circuit. Furthermore, I question the wisdom of the *Hazeltine* holding. *Hazeltine* appears to permit a licensor to evade the spirit of its MFL obligation whenever dealing with subsequent licensees with relatively large projected capacities. The obvious purpose of MFL treatment is to protect licensees shielded by MFL clauses against the granting of competitive advantages to subsequent licensees; the holding in *Hazeltine* appears to frustrate that purpose.[7] I therefore decline to rest on it alone. Rather I find for SGK on the independent ground that Novamont's MFL clause did not entitle it to a lump-sum payment option calculated using Hercules' royalty rates. I reach that conclusion on the basis of the terms of the MFL clause itself and the policy behind MFL treatment.

To begin with, the terms of Novamont's MFL clause, as quoted *supra*, p. 565, provided that Novamont would be entitled to substitute for its own agreement "all of the provisions" of any subsequent license agreement containing "royalty provisions that, when considered in their entirety, are more favorable than those specified [in the Novamont agreement]." There are two ways in which to interpret this clause as applied to the Hercules

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[7] A simple illustration demonstrates the problem. Under *Hazeltine*, if a licensor granted a license containing an MFL clause to a producer with a projected production capacity of 1,000 units using a royalty rate of $10 per 100 units of production, it could afterwards grant a license to another producer with a projected production capacity of 100,000 units for the lump sum of $1,000 without violating its MFL obligation. the MFL clause holder, that is, the prior licensee, would gain nothing by opting for the lump sum payment, for its projected capacity is too small to gain any benefit from it. At the same time, the subsequent licensee would have the benefit of an effective royalty rate one tenth as large as that applied to the MFL holder, despite the fact that the subsequent licensee is one of those who, under the MFL clause, was not to be granted a competitive advantage over the MFL holder.

agreement. One way, that suggested by *Hazeltine*, is to say that "all of the provisions" refers to the precise terms of the Hercules agreement, that is, a paid-up license for 600 million pounds capacity for the price of $1.6 million. For the reasons set forth above, I decline to rely upon that interpretation, *Hazeltine* notwithstanding.

Alternatively, "all of the provisions" can mean all of the provisions pertaining to the method by which the lump-sum payment provided for in the Hercules agreement was calculated. This interpretation makes sense in light of the purpose of prospective MFL treatment. That purpose, as noted above, is to protect licensees shielded by MFL clauses against the granting of competitive advantages to subsequent licensees. However, the purpose is not to redress disadvantages vis-a-vis prior licensees; the holder of a prospective MFL clause enters into the agreement containing that clause with knowledge that it will not protect him from competitive advantages secured by prior licensees.

This method of calculation interpretation is consistent with the purpose of an MFL clause. In instances in which an agreement is entered into between the licensor and a new licensee, after the granting of an MFL clause to a third party, the most favored licensee would be entitled to a license agreement calculated utilizing all aspects of the method whereby the new license agreement was calculated, including the method whereby the royalty rate was chosen. In instances in which a prior licensee's agreement is modified or a novation is executed, the most favored licensee would similarly be entitled to opt for an agreement calculated through reference to provisions in its prior contract, including its own prior royalty rate, then the most favored licensee would similarly be entitled to a contract calculated through reference to the analogous provisions in its own prior contract, including its own prior royalty rate. Thus, its competitive position relative to prior licensees is preserved, and it bears no risk of being subjected to new competitive disadvantages

from subsequent licensees. The purpose of the MFL clause is thereby satisfied.

Application of this "method of calculation" interpretation is complicated herein, however, because, as I have already found, the written agreement does not accurately reflect the actual agreement between the parties in this regard. It is to that "actual" agreement, if indeed one exists, that it is necessary to refer in order to ascertain the effect of the MFL clause.

As previously discussed, two competing explanations were offered at trial with respect to the derivation of the Hercules lump-sum amount. Novamont contends that that amount reflects a forgiveness of royalties for the last three years of the patent term. SGK maintains that no future royalties were forgiven, but that the lump sum covered projected royalties to the end of the patent's life, with appropriate discounts for contingencies and present value.

As outlined above, there is evidence in support of both explanations. Novamont relies on a documentary history of the proposals and counter-proposals preceding the final negotiating session. SGK relies on the trial testimony of Dr. Martin and one page of handwritten notes said to be the record of Dr. Martin's and Sprung's calculations during the final negotiations. Unfortunately, the final figure itself, $1.6 million, provides no insight, for both methods of calculation yield that same result.

Dr. Martin's testimony is somewhat troublesome, because, though his trial testimony was firm and believable and indicated a high degree of conviction regarding the manner in which SGK calculated the $1.6 million figure, that testimony was weakened by his earlier deposition in which he claimed a failure of recollection on precisely that subject. He testified at trial that in the time between deposition and trial, he had reviewed documents and engaged in conversation with Sprung, and had thereby refreshed his recollection on the manner of calculation. I found Martin's testimony at trial credible, in that I found it to be an

honest statement of his present belief regarding the events of nearly a decade ago. I cannot, however, make a determination that his testimony reflected an agreement between the parties at that time. The process of memory refreshment is a mystifying one, and there can be no certainty here that Dr. Martin actually recalled those long concluded calculations rather than merely believing that he did, the wish, perhaps, having become father to the recollection. In any case Martin's recollection simply confirms the use of what one of the Hercules participants termed the "negotiating tools" without achieving the degree of formality necessary to constitute an agreement between Ziegler and Hercules with respect to the calculation of the $1.6 million.

That uncertainty notwithstanding, I find SGK's theory a plausible one. On the other hand, Novamont's extrapolation from the documentary proof is also plausible, and its argument that the parties were unlikely to have abandoned the basis of their prior discussions in the final negotiating session has a certain ring of truth. In the final analysis, however, I am unable to say on this record that the final agreement reflected a three-year forgiveness; indeed, I am unable to conclude that the parties on either side of the negotiating table ever agreed with each other on a method of calculation. It is entirely possible, and consistent with the record of this case, that only the final figure, and not the manner of reaching it, was the subject of a "meeting of the minds" between the parties. In short, there are two possible methods by which the lump-sum payment provided for in the Hercules agreement may have been calculated, and the evidence does not preponderate that either was agreed upon.

In order to have prevailed on its counterclaim under my view of the operation of the MFL clause, *Hazeltine* aside, Novamont would have had to establish by a preponderance of the evidence that a different method of calculation was used in calculating the Hercules lump sum than that used in calculating the offer made

by Sprung to Novamont. In other words, had Novamont established that the Hercules agreement in fact contemplated a three year royalty-free ride, then it would be entitled to a determination that SGK's failure to offer Novamont a comparable grace period was a breach of its MFL clause. As indicated, however, the evidence does not preponderate that such a three-year forgiveness was embodied in the Hercules agreement or that a royalty rate was used which differed from Hercules pre-Novamont rate. Therefore, it cannot be said that SGK breached its MFL obligation.

SGK contends that it offered Novamont a lump-sum payment agreement with the lump-sum calculated according to the method it says it used in arriving at the Hercules agreement, that is, the method applied a royalty rate derived from Novamont's pre-existing agreement to Novamont's projected production, with appropriate discounts for the present value of money and for contingencies. To establish its counter-claim, it was up to Novamont to prove by a preponderance of the evidence that a different method of calculation was used to reach the Hercules agreement than that used to arrive at the Novamont offer. Because it failed to carry that burden, Novamont does not succeed on its counterclaim based on the Hercules agreement.[8]

[6] Finally, Novamont claims to have been defrauded by SGK in connection with the negotiations between it and SGK revolving around the Hercules agreement in two respects. First, Novamont contends that it was defrauded when SGK represented the Hercules agreement as providing for a payment of $1.6 million for a paid-up license when, in Novamont's view, "a large part of this sum went to pay past due royalties that had

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[8] SGK contends that Novamont's rejection of the lump-sum agreement offered to it constituted a waiver of Novamont's MFL rights with respect to the Hercules agreement. Because of my conclusion that Novamont failed to carry its burden of proof on this portion of its counterclaim, I need not reach this issue.

been suspended." Second, Novamont contends that it was defrauded when SGK failed to disclose the manner in which the Hercules agreement was calculated and failed to calculate the Novamont offer according to the same method. Neither contention succeeds.

The first claim fails because the $1.6 million lump-sum payment, as I concluded *supra* pp. 572-573, was in fact a payment for future use and not for past, suspended royalties. There was therefore no misrepresentation in SGK's characterization of it in this respect.[9]

The second claim fails because Novamont has not shown that SGK knowingly misrepresented the manner in which the Hercules lump-sum payment was calculated. As indicated above, the evidence does not preponderate that the Hercules agreement embodied a three-year royalty free ride. Indeed, the evidence does not preponderate that any one method of calculation was agreed upon in negotiating the Hercules lump-sum payment. SGK's offer to Novamont was arrived at through a method of calculation which SGK claims is the same as that used in calculating the Hercules agreement, and because of the uncertainty regarding the manner in which the Hercules agreement was calculated, the record here does not support the contention that that claim is or was knowingly false. Therefore, Novamont does not succeed on its claim of fraud.

On the present record, it is not possible to fix damages because Novamont has failed to account for the period involved in this action. There will therefore be a conference on July 15, 1981 at 4:00 p.m. to discuss the appropriate procedure for going forward with proof of damages in accordance with this opinion prior to the entry of judgment.

IT IS SO ORDERED.

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[9] The forgiveness of past infringement implicit in this arrangement is not violative of Novamont's MFL clause rights for the reasons set forth in the discussion of the Diamond Shamrock agreement, *supra*, pp. 570-571.

APPENDIX C

UNITED STATES COURT OF APPEALS
SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the twelfth day of May, one thousand nine hundred and eighty-three.

______________________________X

STUDIENGESELLSCHAFT
KOHLE m.b.H.,
Plaintiff-Appellee-Cross Appellant,

v.

NOVAMONT CORPORATION nna.,
U.S.S. NOVAMONT
INCORPORATED,
Defendant-Appellant-Cross Appellee.

______________________________X

United States Court
of Appeals
Filed May 12, 1983
A. Daniel Fusaro,
Clerk, Second Circuit
Nos. 82-6143-7163

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the defendant-appellant-cross appellant, U.S.S. Novamont Incorporated.

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active service and to any other judge on the panel that heard the appeal and that no such judge has requested that a vote be taken thereon.

A. Daniel Fusaro, Clerk
by

/s/ Francis X. Gindhard

Francis X. Gindhart,
Chief Deputy Clerk

APPENDIX D

Supreme Court of the United States

No. A-96

NOVAMONT CORPORATION nna. U.S.S. NOVAMONT CORPORATION,

Petitioner

v.

STUDIENGESELLSCHAFT KOHLE m.b.H.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI

UPON CONSIDERATION of the application of counsel for petitioner(s),

IT IS ORDERED that the time for filing a petition for writ of certiorari in the above-entitled cause be, and the same is hereby extended to and including September 1, 1983.

/s/ Thurgood Marshall
Associate Justice of the Supreme
Court of the United States

Dated this 9th day of August, 1983

APPENDIX E

United States Constitution

Article I, Section 8, Clause 8

"Patents and copyrights

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;"